THE INDIAN CURRENCY SYSTEM

(1835—1926)

[*Sir William Meyer Lectures for the year* 1929]

BY

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TO

THE MEMORY OF

ALFRED MARSHALL

PREFACE

At a time when the task of monetary reconstruction on comprehensive lines and of the adoption of an improved standard is occupying the attention and energies of India, the utility of a review of the main tendencies of currency development in the country in the past is obvious. When, therefore, the University of Madras did me the honour to invite me to deliver the Sir William Meyer lectures for 1928– 1929, I selected for my subject the evolution of the Indian currency system. That topic seemed also the more appropriate, in view of the association of the lectures with the name of Sir William Meyer—one of the most eminent currency experts that India has produced.

The present book, which embodies those lectures, differs from the other works on the Indian monetary system in confining itself to a consideration of the leading tendencies in the development of that system. While less attention can be devoted in such a review to the details of currency history, it can be fairly expected to give some account of the influence exerted by the general progress of monetary theory and practice on the currency policy of India, as well as of the causes and motives of the various changes in our currency system.

It need hardly be said, that for the student of the theory of money the currency experience of India is full of interest and instruction. The discussion of the causes and effects of the successive changes in India from Bimetallism to Silver Monometallism and from that to the Gold Exchange Standard forms one of the most important and fascinating chapters in the monetary history of the world. We are now at a sufficient distance in time from most of those

changes, to envisage clearly the course of events and to discuss calmly the merits of the measures adopted. We are assisted in our task of understanding and interpreting the trend of the monetary history of India, not only by the great development of monetary theory and practice during the present century, but by the recent publication of quite a number of valuable realistic studies of the currency, prices and exchange problems relating to various countries. Studies like those conducted by distinguished economists like Taussig and Keynes and like Viner and W. Angell can throw much new light on our old problems, and can give material help in a re-consideration of our long-standing controversies.

It might appear to some readers, that unduly large space has been devoted in the book to the consideration of the various currency proposals in which the monetary history of India during the latter half of the nineteenth century was so rich. It is submitted, however, that in a historical and critical record of our monetary development, many of these proposals form so many land marks either as illustrating or foreshadowing the course of events. In many cases the proposals form the stepping stones of monetary reform. For instance, one can scarcely understand how strongly events were leading up to the adoption of the Gold Exchange Standard in India unless one is familiar with the proposals of the Government of India in 1878, with the currency scheme put forward by General Strachey in 1886 and with Sir D. Barbour's famous minute of 1892. So also the study of the various gold currency schemes associated with the names of Mansfield, Trevelyan and Temple will throw much light on the currency situation of India in the 'sixties and the 'seventies. The various attempted solutions of the monetary difficulties of those days afford, by implication, excellent descriptions of the prevailing currency and price conditions, and are very useful guides to the aims

and ideals of our currency authorities. In a word, the study of such concrete proposals is as valuable to the student of monetary history and theory as is the analysis of "leading cases" for the lawyer.

All writers on Indian currency have to express their obligations to the writers of the more valuable memoranda which were submitted to the various currency commissions and committees. Some at least of these memoranda and evidence can justly claim an important place in the currency literature of the world. They form the best introduction for Indian students to a sound and fruitful study of monetary problems.

I am obliged to Professors Niyogi and Chattoraj for assistance in seeing the book through the press.

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LECTURE I.

THE RÉGIME OF SILVER MONO-METALLISM (1835-1878.)

The importance of the study of Indian Currency History.

The monetary history of India is of absorbing interest to the student of currency theory and systems. From a remote antiquity, India has played a prominent part in the monetary affairs of the world. The great and sustained power of the absorption of precious metals which India has always possessed and exerted, was the cause of a great deal of speculation in the days of Augustus and Pliny; it gave rise to important currency controversies in England under Elizabeth; and it still influences the gold policies of the great central banks of the day. Coming down to the last century or two, we notice that there is not a leading variety, or even a subsidiary species, of monetary systems which has not been either tried, or suggested for adoption and subjected to thorough discussion, in our country. We have either tried, or planned to introduce, Bimetallism, silver monometallism, a gold standard and currency, the limping standard, the Gold Exchange Standard and the Gold Bullion Standard. Our experience of Bimetallism during the seventeenth and eighteenth centuries has been as long, varied, and as rich in lessons, as that of any other country. Our projects for a gold currency go back to the days when gold mono-metallism was not yet adopted by most of the Western nations. In the Bimetallic controversy of the last century, the co-operation of India was eagerly sought, and would have proved of great and even of decisive importance. We have developed the Gold Exchange Standard, and have

taught it to numerous countries. As a well known American economist—Conant—has observed, in 1893 India "undertook an experiment of great importance to the financial world," and "the experience of fifteen years which have followed that experiment has taught many lessons in monetary science." It may, indeed be said to have "blazed a new path, in the principles of money at least in their practical application". Still more recently, India has been one of the first countries to turn towards the Gold Bullion Standard, and its path to that standard has been prepared at once by careful study and by vigorous discussion and controversy. It would indeed be the fault of the student, if from such a rich and varied experience he fails to derive valuable lessons in monetary theory and practice. Looking to the future, too, we can anticipate on good grounds a considerable growth of the monetary power of India. In the past, India while possessing a giant's strength as regards the absorption of precious metals, has sometimes used it like a giant. In the future, when the country has learnt the benefits and practice of foreign investment, she will command greater monetary influence abroad than ever, and will co-operate with the great commercial nations in pursuit of mutual advantage.

But while, in this narrative, we shall be concerned in the main with the various stages in the development of the monetary standard in India, and with the adaptation of the gold standard to its Indian environment, there are other very interesting aspects of the monetary problem of India to which we shall be able to refer occasionally. One important topic of this sort is the peculiarity of the working of any monetary standard in a country in which the hoarding practice is still to some degree prevalent, and where credit control yet remains to develop. The experience of India, especially in the first decade of the present century, might well throw some light on the question of the influence

of the prevalence of such conditions upon the automatic working of monetary systems. Since, as has been often said, there is little scope for the method of experiments in Economics, there is the more reason why special value should attach to the observation of the working of the same currency system under different conditions. To come to another topic, Professor Taussig and other investigators have discussed the influence of any improvement in the position of a country as regards foreign trade on the level of incomes and prices in that country. This type of analysis, as regards the effects of any great change in international demand on the level of incomes and prices in a country, is very well illustrated by the rise of Indian prices in the periods from 1900 to 1914. It might be added, that there are few periods in monetary history, which can shed so much light on the inter-relations between the factors of the balance of trade, foreign exchange and the volume of currency and upon any causal sequence among the group. Then again, more recently Professors Taussig and Viner have examined the influence of foreign loans on the price levels of countries like the United States and Canada, during selected epochs. It will be seen in this connection that in the period 1857-1864, particularly, prices and wages in India were similarly influenced by continued borrowing from abroad. In those days, India's absorption of silver and coinage were in a great measure affected by such foreign loans, and so was also the price level. Looking farther, we find many studies made of the relations between trade cycles and the course of prices, as well as of the relationship of a cyclical character between the price levels of different countries. On that side, too, we have an abundance of rich material in the monetary history of India. Thus, it was the backwash of the great depression of 1893-6 which rendered the process of stabilisation of exchange proposed by the Herschell Committee of 1893 a longer and more difficult affair than

had been expected. The trade boom which began late in the 'nineties will be seen to have a rather curious effect on the proposals of the Fowler Committee. It rendered indeed the problem of stabilisation of exchange at 1s. 4d. easy; but on the other hand, by creating a great demand for rupees, for the purpose of financing our unprecedented exports, it contributed materially to prevent the success of the experiment in gold currency. To give another instance, we note that the short-lived post-war boom and the great depression which succeeded it so abruptly, exerted a curious influence on the proposals of the Currency Committee of 1919 and on their fate. On the one hand, the proposals were formed in the light of the conditions of the short but strong boom; and indeed they might be said to have been dictated by the boom conditions. On the other hand. the abrupt transition to conditions of a great depression—a transition which no foresight could have anticipated—doomed the proposals to failure, and rendered the efforts made to support the exchange by the sale of Reverse Councils futile. Finally, we shall have occasion to trace the evolution of the correct notions about, and definition of, the Gold Standard, in the course of the currency controversies in India. It will be shown that correct and modern notions about the Gold Standard were developed and formed in India at least as early as in any other country.

The attainment of uniformity of currency.

We start our narrative with the passing of Act XVII of 1835 which established a silver mono-metallism in India. We note that the year 1835 was a memorable one in our monetary annals, for the monetary change which was introduced in it was the culmination of two processes of which the working could have been watched for decades. One of these processes consisted of the decline of Bimetallism; while the other consisted in the series of measures intended to secure uniformity of silver coinage. Correspond-

ingly, the Act of 1835 had a double aspect. On the one hand, under it "the present silver rupee was formally established as the standard coin of the whole of British India", while on the other hand, it was enacted that "no gold coin shall henceforth be a legal tender of payment in any of the territories of the East India Company". It formed, for the first time, for the country as a whole a national currency which could evolve on modern lines.

Our information as regards both the tendencies noted above has been recently added to by the researches of Prof. Dowell on the Madras side and of Dr. Sinha as regards the course of events in Bengal.(1) The extraordinary diversity of coinage in India in the eighteenth century is shown by Prof. Dodwell's remark that "the first English collectors had to receive on account of the revenue at least 72 varieties of gold and 60 varieties of silver coin", Bengal too possessed a bewildering variety of silver rupees used in different localities and favoured for different purposes. Not only did different kinds of rupees circulate in different districts", observes Dr. Sinha, "but even the same kind of rupee could not be used in any one district for all commodities. These diverse coins again were in various stages of debasement". It is no matter of surprise that the problem of uniformity of currency all over the country took over a century and a half to solve, and that it took many decades, even to secure the currency of a single variety of rupee through any one province. The great difficulties in the way were the expense and length of time involved in the process of recoinage, and the risk and expense of sending debased coins to the central provincial

(1) Prof. H. Dodwell, " Substitution of silver for gold in South India (*Indian Journal of Economics*, January, 1921) ; Prof. J. C. Sinha, *Economic Annals of Bengal*, pp. 56-62; 220-237. Mr. F. C. Harrison, "The past action of the Indian Government with regard to gold" in *Economic Journal*, Vol. III.

mint. When affairs were in such confusion, the schemes of impetuous reformers like Sir Philip Francis, to introduce Silver monometallism in India at one stroke and thus to anticipate the legislation of 1835 by over a hundred years, were foredoomed to failure. Nor should we forget that the progress of uniformity of currency, though ultimately beneficial, brought "much immediate and widespread hardship on the people"; for the withdrawal of debased currency led to a reduction of the circulating medium for a time and led to great fluctuations of prices. Our country has gone through many currency difficulties since the legislation of 1835 but they cannot compare with those which faced the earlier administrators of British India.

The main steps in the progress of securing uniformity of currency in India might now be briefly indicated. By a long process of the survival of the fittest the eighteenth *San Sikkah* rupee held the field in Bengal till the legislation of 1835. In Bombay, the Surat rupee being lighter in weight showed the truth of Gresham's law by displacing the heavier "Bombay rupee"; until it was itself displaced by a new Bombay rupee in 1817. But to Madras fell the honour of giving its rupee as the standard for all India. By the despatch of April 25, 1806 to the Madras Government, the Directors laid down the lines for securing monetary uniformity for India; and it was the Madras rupee of 180 grains weight coined in 1818 which was adopted in Bombay in 1824. Much of the credit of the reform was due to James Prinsep, who worked for it since 1812, and whose hand has been traced in the Regulation of 1833 which preceded the legislation of 1835. It is to be noted that even the last stage of the reform required a whole generation to carry out, since the ideas of the Directors' Despatch of 1806 were translated into legislation only in 1835.

The difficulties of the Bimetallic regime

The failures and difficulties of local Bimetallism even in countries where it has been established under the most favourable conditions has been the theme of historians of monetary systems like Laughlin. Long experience has proved that a concurrent circulation of gold and silver is almost impossible to maintain by a country, in the face of constantly changing relations of gold and silver in the bullion market. Thus Laughlin informs us as regards the Bimetallic experiment in America, that "there probably never was a better example of the double standard, one more simple, or one for whose successful trial the conditions could have been more favourable". But he adds, "this young and promising offspring of Hamilton started well, but soon began to limp, and then to walk on only one leg".(1)

If such were the troubles of local Bimetallism as practised by individual countries under highly favourable conditions, the difficulties of maintaining it were far greater in India in the eighteenth century. And first, let us indicate the main obstacles to the maintenance of the system, as shown by the experience of the Madras Presidency. To start with, the supply of gold was not continuous and automatic but small and discontinuous, being dependent upon the resources and opportunities of the English and French East India Companies. This cause was by itself enough to render the concurrent circulation of the two metals out of the question for long periods. But further, the great hindrances to the keeping together of the official and market ratio were multiplied in a province in which "the value of silver varied from district to district". On various occasions again, the ratio obtaining in India differed considerably from that prevailing abroad. We also

(1) Laughlin, History of Bimetallism, pp. 22-24.

read of other special causes of local variations in the relative values of gold and silver; thus we find silver falling in value when invading armies from the North expended their wages in the Southern provinces. Nor was this all; for, since only parts of India were under the Bimetallic regime, there was a constant drain of gold from such parts to the rest of the country. It would be difficult to discover another period or place in which the circumstances were so favourable for the action of Gresham's Law. Under such conditions the Indian experiments in what might be called a provincial Bimetallism were hopeless from the start, and the narratives of Prof. Dodwell, Mr. Harrison and Dr. Sinha supply us with a long list of alterations of ratios and break-downs of the system. Finally, it was the dwindling away of the local stocks of gold, caused by the discontinuance of the overvaluation of gold, which accounted for the disappearance of Bimetallism in the South of India.

Equally instructive was the other provincial experiment of Bimetallism in Bengal. In general we might derive two lessons from these experiments; the first is the impossibility of maintaining the concurrent circulation of the two metals under a local Bimetallism; the second is the great convenience of supplementing the rupee currency with a gold currency in the case of India especially so long as the paper currency system of the country is undeveloped. Thus, in the case of Bengal it was the scarcity of silver currency which led Clive to inaugurate Bimetallism; and it was the failure of the scheme of paper currency of Hastings which made its continuance necessary. It was also the dearth of specie which compelled Lord Cornwallis to reintroduce Bimetallism in 1792 in spite of all its inconveniences. But, it is to be noted that the convenience of the larger volume of the currency was purchased at the cost of the continuance of a discount on

one of the metals. In spite of all official efforts "the disappearance of the *batta* was only temporary. It was impossible to find any remedy for this evil so long as gold and silver both continued as currency". Indeed, while on one hand the currency was being supplemented by the addition of gold, on the other hand, the action of Gresham's Law was contracting either the silver or the gold portion of it. This was noticed repeatedly by the administrators of the day by Hastings and Francis as well as by Sir John Shore who pointed out that the sole remedy for this state of things was to be found in "the establishment of one metal only in coin as a legal tender of payment in all transactions, public and private." We also find how abundant experience impressed the view on Lord Cornwallis too that "one metal alone should form the standard of value".

Abolition of Bimetallism.

There was then no reason at all to regret the disappearance of Bimetallism in 1835; and indeed the wonder is that the local authorities of the different provinces so long resisted the proposal of the Directors to abolish the system formally. It might be that the evils of Bimetallism had vanished with the practical adoption of the silver standard, and that the survivals of gold coinage appealed to the local Governments as a source of prestige. Nevertheless, it was well that Bimetallism was formally abolished in 1835. Here, as elsewhere, we have to balance the contingent and possible losses and gains of the alternative policies. Had Bimetallism been continued in India, it would have facilitated the adjustment of balance of trade in periods like the early sixties. But in return for this service, it would have involved India in all the troubles experienced by the Bimetallic countries after the middle of the century. Nor were these troubles long in making their appearance; for only fifteen years after 1835 began those discoveries of gold in California, Australia and elsewhere which initiated

the era of the great and continuous changes in the relative values of gold and silver. Indeed, the trials of India under a Bimetallic system would have been even greater than those undergone by countries like France. For these latter at least possessed abundant stocks of gold and were rich countries whose inhabitants were accustomed to and able to use gold and what was better—notes—in ordinary transactions. It would have been a much more serious state of things for India, if silver had begun to move away from it in large quantities, as it did from France after the gold discoveries of the fifties. Such a flight of silver would not only have caused great inconvenience, but would have checked the great extension of money economy that took place in the nineteenth century in India. A well-known author, writing as late as the end of the second decade of the present century, observes that in India "the circulating media have to cover vast areas, in many of which, it is true, currency has not yet percolated to any degree".(1) The alternate flight of gold and silver which would have been the necessary result of the continuation of Bimetallism in India would have not only checked this spread of money economy, but would have disorganised the monetary system of India.

In studying the course of legislation for the abolition of Bimetallism in India the student will be interested in tracing on it the effect of the great treatise of Lord Liverpool on the "Coins of the Realm" which appeared in 1806. This treatise had the privilege of *directly* influencing the currency policy of at least two great countries. In England it was the precursor of the Act which established the gold standard in 1816; while in India it called forth the well-known Minute of 1806 from the Governor-General in Council, as also a letter from the Directors which recom-

(1) Shirras, *Indian Finance and Banking*, p. 9.

mended the abolition of Bimetallism. In 1817 the opinion was reiterated by the Board of Directors that "no ratio ought to be fixed between the standard silver coin and the gold coin, but that gold should be left to find its own value". These views finally bore fruit in the great measure of 1835.

But, while no one deplores the abolition of Bimetallism there are some who, following the views of Prof. MacLeod, urge that it was a great error to substitute for it a silver mono-metallism, and that the establishment of a gold mono-metallism would have been the right policy to follow.(1) Need it be pointed out in reply that every condition precedent of the establishment of an effective gold mono-metallism was wanting in India at that period? A country which was poorer than it is even now, of which the trade was undeveloped at the time, in which money economy had yet to make great progress (and great quantities of rupees were wanted to furnish a currency where no general medium of exchange existed before) and in which banking was in its infancy, was hardly prepared for the introduction of a gold mono-metallism, especially at a time when most of the wealthiest and most progressive countries were as yet on a silver standard. While gold currency would on many occasions have served a useful purpose in India by supplementing the resources of silver, it would be an exaggeration to say that India, was prepared for a gold mono-metallism as far back as the year 1835. As was observed, in 1864, by no less a champion of gold currency than Sir W. Mansfield, "within the last quarter of a century a system of barter still prevailed in many parts of India. The country was too poor in some parts to own the presence of money, to be able to pay for the convenience of it"(2). When admittedly, parts of the country were too poor for a silver currency, and

(1) H. D. MacLeod, *Indian Currency* p.15

(2) Papers relating to the introduction of a Gold Currency in India (Calcutta, 1899) p. 52

when even the rupee could not penetrate everywhere, a gold mono-metallism was quite out of the question. It might also be remembered that many of the wealthiest countries of the world were as yet on the silver standard, and that the gold standard was still the exception and not the rule.

In order to understand the true scope and objects of the notification of 22nd December, 1852, by which "gold was totally demonetised" we have to examine the policy followed with regard to gold since 1835. Neither the despatch of 1806 nor the Act of 1835 aimed at a complete demonetisation of gold and provisions had been introduced in the Act for the continuation of the coinage of gold. But, between the desire to avoid Bimetallism, of which the experience had been long and bitter, and the wish to maintain gold as a subsidiary part of the Indian Currency, a difficult and somewhat illogical situation had been created. In order to encourage a subsidiary gold currency a proclamation of 1841 authorised officers in charge of public treasuries to receive gold coins; while with the same object the seigniorage on gold coins had been already reduced in 1837. These efforts "to galvanise the gold mohur into life"—as Mr. Harrison has described the policy—had no effects whatever, so long as gold could command a better price in the bazars than the fifteen rupees as fixed by Government. No inconvenience was felt from this state of things, as long as the intrinsic value of the gold mohur continued to be very nearly the same as that of fifteen rupees, though even so, the expectations that the gold mohurs would go into circulation were not realised, and the mohurs kept accumulating in the treasuries. When, however, with the gold discoveries in California and elsewhere, the value of gold began to fall in relation to silver, the inconvenient consequences of the proclamation of 1841 began to manifest themselves. On the one hand, it paid

people to discharge their obligations in the cheaper metal, and as a result there was an accumulation of the gold mohurs in the Treasuries; on the other hand, as the gold mohurs were not legal tender, Government could not reissue the mohurs, and had to lose considerably on their resale. As the gold discoveries of the fifties constituted a great revolution, there seemed to be no end to the financial loss thus incurred if the *status quo* was indefinitely maintained, Mr. Harrison has observed that, as usual, "the discarded and cheapening metal finds its way to the East, and the recorded export thither from 1847 to 1854 averages considerably over a million sterling yearly." The various alternative courses of action before the Government under these circumstances might now be considered. The first alternative was to make gold legal tender again; but this course, though it could save Government from the loss on mohurs received by it, would have led them straight towards Bimetallism with all its dangers. The second available course was to prohibit the receipt of gold coins by the Treasuries altogether; and this alternative the Government had adopted. The only other possible course was, as James Wilson pointed out later, "to reduce proportionately the rate at which the gold coins would be received so as still to leave a margin for loss." But as regards such a policy, he further pointed out, that the fluctuations in the value of gold and silver were bound to be very frequent, and "to call a coin 'money' the value of which could not be vouched for from one day to another to say nothing of the trouble of ascertaining and computing the fluctuations would be a mere misnomer".

Those who condemn the measure of 1852 outright must also be those who belittle unduly the great changes in the relative values of gold and silver which began in the 'fifties' as well as the potential loss from receiving the depreciated gold into the Treasuries in unlimited quantities. One must regret,

with critics of the measure like Laing (Finance Member 1861-62), that "it was found necessary to exclude gold altogether from the ordinary range of money transactions in India". But the main possible alternatives were only two, as both Wilson and Laing pointed out(1). The first was a resort to Bimetallism which no one wanted to see restored in India. The other was the establishment of gold mono-metallism and dethronement of the rupee. That is, however, the great problem which we are still thinking of attacking in our own day, and it is a task of which the formidable difficulties we have learned to appreciate fully. The task was certainly not feasible in the middle of the last century. All that was possible in those days consisted, as Laing admitted, of "cautious and tentative experiments" with regard to the future use of gold. A fluctuating rate of exchange might possibly have been so arranged as to allow the Treasuries to receive imported gold in exchange for rupees. "After a time, if the use of gold became more general and its value more fixed, some further step might be taken". No doubt, something might have been achieved on these very modest lines to prevent a complete divorce of Indian currency from gold. But one could scarcely call it an introduction of the gold standard.

Inauguration of the Paper Currency System.

Before proceeding to consider the movement for gold currency which began in the sixties, we have to note the introduction of a new factor in the monetary situation—the inauguration of a State paper currency in India; and any consideration of this new monetary development would be imperfect without a brief review of the currency policy and ideals of James Wilson who initiated the proposals for the paper currency. Had destiny granted a longer tenure

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(1) Papers relating to the introduction of a Gold Currency in India, pp. 8-12 and 16.

of office and a more free hand to James Wilson, his bold and enlightened policy, which utilised what was best in the economic doctrines of the day while it rose superior to current economic shibboleths, would have changed the monetary history of India. He was against experimenting in the direction of a gold currency, for he believed a gold mono-metallism neither possible at the time nor likely to work justice, in case of the numerous obligations incurred in silver; on the other hand he suspected that any attempt to introduce a gold currency at the time would introduce into the country all the inconveniences of a double standard. He believed that, at least for the time being, it was to the advantage of India to maintain silver mono-metallism "in as much as silver seems to be an appreciating metal, while gold is probably still falling". But he would supplement the silver standard by a "well regulated paper currency" which would secure for the country all the conveniences claimed for a gold currency(1). His proposals for a system of note issue were far in advance of the dominant theories of the day, and would have endowed India with a system of paper currency far more elastic and progressive than the one which was actually initiated in 1861. The essential points of superiority of Wilson's scheme over that adopted in 1861 might be briefly adverted to: His scheme was based on the principle that while paper is convertible it must needs "conform precisely in all its operations to the movement of metallic money". He was therefore against following the fixed fiduciary system of reserve which retarded the progress of paper currency in England, and he proposed the adoption of a proportionate reserve system under which notes were to be issued in the proportion of one-third against bullion and two-thirds against securities. These were not, however, meant to be hard-and-fast proportions, and as his colleagues pointed out,

(1) Wilson's Minute of the 25th December, 1859.

it was his intention to proceed tentatively in the matter. While this element in his scheme would have endowed the Indian currency with elasticity, its convertibility in silver rupees would have been secured; and as Wilson meant to keep out Bimetallism at all costs, there could have been no doubt as to the metal in which the notes were to be redeemed. There were other desirable features of the Wilson scheme—the creation of a Department for the issue of notes which was to be independent of the Government of India, and the issue of notes of small denominations. While he was against issuing the proposed paper currency through banks, on the ground that it should be issued under a single authority and be of general use, he was not unmindful of the great value of banking development. In fact, his monetary proposals formed a consistent and comprehensive whole. He projected a silver mono-metallism, but one modified and supplemented by a highly elastic system of note issue adapted to the character of the transactions of the country, and as far as possible independent of the Government finance. Such a system, properly modified in the light of experience, would have greatly weakened the case for a gold currency, while it would have educated the public in modern currency methods, so that the hold of silver on India would have slackened and the ultimate dethronement of silver would have been facilitated. A popular and progressive paper currency would thus have hastened the abolition of silver mono-metallism and the introduction of a true gold standard.

Mr. Laing who succeeded James Wilson held very different views from him both as regards the system of note issue and as to money matters in general. For one thing, he was as an advocate of a gold currency. Even a double standard with all its inconveniences he would have liked to be adopted "as a transition process to the abandon-

ment of silver and the substitution of a gold standard". Nevertheless, "under the existing circumstances when a season of tranquillity and repose in financial matters was very desirable", he was not prepared to make any important alterations in the currency policy of the country, and was anxious "simply to leave the door open for cautious and tentative experiments with regard to the future use of gold"

As regards the paper currency system, he ranged himself against the "small minority of able men, among whom Mr. Wilson was one of the most distinguished", and on the side of "orthodox opinion as recognised in modern England". He thus avowedly belonged to the Currency School. Consequently, he agreed with Sir C. Wood, the Secretary of State, in adopting for India the principle of the Bank Act of 1844, and in fixing the fiduciary issue at £4 millions—that being "the extent of paper circulation provided for under the existing system through the chartered banks". Wilson's bold idea of a large paper currency adapted to the size of local transactions also alarmed his successor. "I do not hesitate to affirm my firm conviction that if we could succeed in creating a large circulation of small notes throughout India, based on a reserve of Government securities to an extent of anything like two-thirds, or any large proportion of the total issue, such a system could not stand the strain of the first serious political or commercial crisis". The idea of making a large direct profit to the State from the note issue was abandoned as attended with risks. A novel feature was introduced by Laing in view of the potential introduction of the gold currency in India; gold was to form one-fourth part of the reserve held against notes in coin and bullion. The idea was that "by thus fixing a *minimum* value at which gold should be received at the Government Treasuries, its "superior convenience" and "its adaptation to native wants" might in course of time

lead to "the introduction of a considerable auxiliary gold currency". There was also a more ambitious motive behind this clause, and it was expected that the gold thus held might be increased until notes could be issued against the gold. This clause remained a dead letter until 1865.

Coming to the question of the agency of issue, again, Laing was in opposition to the views of Wilson and Sir C. Wood who wanted a Government agency. Laing, having watched the experiment of government paper money in various countries, preferred the agency of banks. He expressly stated that, if he had consulted his own views, he would have placed the Bank of Bengal on the same footing as the Bank of England, but in deference to the views of the Secretary of State he modified his proposal and would make the existing banks merely the agencies for issuing and paying the notes.

The results of the prolonged controversy relating to the paper currency system of India, and of the successive changes of Finance Members, were not very favourable. Wilson's comprehensive and efficient scheme was put aside —as Sir W. Mansfield put it "it was grievously mutilated". So, also, Laing's promising suggestions as regards the employment of banking agency in the management of the paper currency were turned down. What India obtained in 1861 was a mere replica of the English system of note issue; and as Prof. Marshall said later, "England is a specially bad example for India to follow in matters of currency". While long experience has endorsed this view unmistakeably, even contemporary opinion was not too favourable to the plan embodied in the Act of 1861. The Mansfield Commission's Report emphasised that "the original institution of paper currency in 1861 was eminently of a tentative character" and that "extreme caution was observed with respect to the limitation of issues, the organisation of

circles, and the guardianship of the convertibility of the note''. The opinion of the commercial interests about the measure was very similar, and as the Bombay Association observed in their memorial to Lord Lawrence, ''the Currency Act of 1861 does not provide any remedy for the defects of the monetary system''.

The demand for a gold currency.

The inadequate character of the Paper Currency system adopted in 1861 was one important cause of the demand for gold currency which arose in 1864. The advocates for gold currency in those days were fully aware that paper currency was ''a dangerous rival to gold''; and no memorandum, report or memorial in favour of gold currency was felt to be complete without a reference to the inadequacy or impossibility of paper currency in India. But apart from the weakness of the paper currency, there were many other important causes which contributed to the demand for more currency at the time. India was in fact preparing to take one of the great gulps of currency in which it indulges periodically, and we must look at trade conditions first in order to explain what appeared to many people at the time as a purely monetary phenomenon requiring a change of the standard. As early as the Crimean War, the exports of India had received a stimulus owing to the fact that the ''war transferred from Russia to India a substantial demand for oil seeds and fibres''. The American Civil War coming some years later greatly increased the value of the cotton exported from India. This factor would by itself have rendered the adjustment of the trade balance difficult, when combined with the diminished production of silver in the world. As it was, India had been taking on an average ''more silver annually than the whole world produced'', during the period from 1857-58 to 1862-63. This was a serious state of things, in view of the fact that many of the countries of the West were still on the silver standard.

But other causes besides wars had contributed to this state of things, and had swollen the balance of trade in favour of India for the time being.—India had been borrowing large sums from abroad for suppressing the Mutiny, as well as for carrying out public works; in particular, large sums had been borrowed for the construction of railways and canals. The economic effects of foreign loans on the flow of specie and on prices and wages in the countries concerned, have been recently studied by Professor Taussig, Graham, and Viner, among others. We find that, in accordance with their theories, the flow of specie (*i.e.*, silver) towards India was greatly increased while prices and wages also rose in this country. The increased flow of specie to India between the years 1855-1856 and 1869-1870 was indeed a remarkable phenomenon. Its abrupt termination with the removal of the effects of the wars and of the large borrowings was also very significant.

The financial authorities of the day were naturally puzzled on finding unmistakable signs of monetary stringency existing side by side with a growing supply of the circulating medium. As Sir C. Trevelyan (then Finance Member) observed in his famous Minute of 20th June, 1864, "the late crisis was not caused by any deficiency of the circulating medium of India. The circulation was rather redundant than deficient." Perhaps, however, the authorities failed to allow for two important factors which were influencing the situation. The habit of hoarding was fairly strong in those days, and hoarding is naturally stimulated in a period of very high profits and windfalls—and the sixties constituted such a period pre-eminently. We have traditions, on the Bombay side of how some of the fortunate producers of cotton shod the cattle drawing their carriages with silver, the tyres of the carriages being also made of the same material. At the other end of India, "it is said that since the cotton crisis gold bangles have in

some favoured cotton districts become almost as common as silver bangles were before".(1) But, besides hoarding, there was another potent cause of the growing demand for money—the growth of money economy. Thus Sir Bartle Frere remarked that "one of the causes of the increased demand for silver and gold may be found in the simple fact that in such lately pauper districts an entirely new circulation has had to be recently supplied".[2] In the sixties, changes like the increase of cultivation of commercial crops and the rise of wages and the increase of communications and of mobility of labour must have necessitated a considerable growth of money economy.

Views of Mansfield and Trevelyan on gold currency.

The controversy of the time regarding the introduction of gold currency produced two representative documents of great ability and interest. The first of these was the minute of the 8th March, 1864, by General Mansfield (Commander-in-Chief of the Bombay army), which argued that owing to "old social habits" the people of India were not likely to take to the use of notes—"the artificial devices of the Art of Commerce". Now, since the social habits of the Indians "preclude the idea of paper currency being allowed fair play" the right policy was, he urged, to introduce a gold currency gradually and in aid of silver, in spite of the certainty of India having as a result to pass through Bimetallism as a transition stage. In about a generation, the progress of the substitution of gold for silver in the currency of India was expected by him to be sufficient for the establishment of a gold mono-metallism on English lines—silver being reduced to the position of token coinage. Thus, even in his view, it would take efforts lasting over a generation to introduce a gold standard into India and to,

(1) General Mansfield's Minute of 8th March 1864, chapter 8.

(2) Papers relating to the Introduction of Gold Currency in India p. 52.

dethrone silver. Apart, however, from making gold legal tender, General Mansfield did not indicate any methods or resources for procuring gold or for causing it to remain in circulation. As regards the difficulty of maintaining the proper ratio between the two metals he asserted—on very insufficient grounds—that "the values about declared in the practice of recent years will be maintained". He greatly underrated in fact the difficulties of the problem of fixing the ratio between gold and silver. His only suggestion as regards that problem was, that gold and silver "must run their chances as commodities of trade without assistance", or that "the two metals should be left to fight the battle for supremacy."

The other document, which is of even greater importance in the economic history of India, is the minute dated 20th June, 1864, by Sir C. Trevelyan (Finance Member, 1863-65). It was clear to the keen economic vision of Trevelyan that the crisis of 1863-4 "was not in its origin or true nature a monetary crisis", but that it was due to the difficulty of adjusting the heavy balances of trade in face of "the unwillingness of the people of India to accept ordinary mercantile equivalents". For facilitating such adjustment of balances, and in view of the growing wealth of India gold currency, he suggested should be added to the silver currency in an auxiliary capacity. It would not do to be content with the indirect use of gold for currency purposes, such as his predecessor Laing had arranged, for by the provision that part of the Paper Currency Reserve should be held in gold. Sir Charles Trevelyan was aware that his proposals would inaugurate Bimetallism in India, but then, he argued, "nations must pass through this stage before they arrive at a satisfactory state of their currency". As with its superior convenience for transactions, gold currency would increase in India, less of silver would be coined in time, and, as in France, silver "would of itself subside into

a token coinage". As regards the ratio to be fixed, Sir Charles proposed to value the sovereign at Rs. 10, on the ground that Australia was the nearest source of supply of gold for India, and he had only to add to the price of gold in Australia the charges of transportation thence. Indeed, he assumed, in fixing the rate, that Australia would see its way to reduce its export duty on gold and so to lower the cost of the metal in the interests of India.

In the light of events, it is very interesting to study the diagnosis of the then existing situation by such authorities as Sir C. Trevelyan and General Mansfield. As we have seen, the former exhibited superior economic insight in proceeding on the ground that the crisis of 1863-64 was in the main a commercial and not a purely monetary crisis, both in its origin and true nature. The difficulty being that of the adjustment of balances, it was certainly the right course to try to supplement silver—as an import—by gold. In fact, in arguing on these lines, Trevelyan was anticipating the recommendations of the Currency and Exchange Committee of 1919. The dependance of India upon the supplies and price of silver would no doubt have been diminished by having an auxiliary gold currency. But while this proposition was undoubtedly true (so long as no attempt had been made to give India a genuine gold standard in its most advanced form) yet, as economic observers, both Trevelyan and Mansfield erred in assuming that the prosperity which the sixties brought to India was based on permanent foundations, and that India had assumed at a stride its place among the wealthy nations of the world. These abnormally favourable balances soon ceased to make their appearance with the end of the American War and with the close of the particular epoch of large borrowings from abroad. Simultaneously, the great demand for more currency—including that for gold currency—came to an

end, and no further pressure was put upon the Government from any particular quarter to secure those objects.

Proceeding further to examine the remedies proposed, hardly any one would be against the idea of Trevelyan, Mansfield or Temple that it would have been desirable by itself to introduce gold currency as auxiliary to the existing silver coinage. Unfortunately, in that age which was marked by great fluctuations in the relative values of silver and gold, the proposed step would have introduced new and most formidable difficulties. The first difficulty was that of fixing the relative value of gold and silver coins in India and we shall see how Trevelyan's scheme foundered on that rock. Indeed, the controversy regarding the rating of the rupee in terms of gold, which began with the minutes of Trevelyan and Mansfield on the subject, ran its course for some years, and eminent financiers of India like Strachey, Arbuthnot and Dickson took a hand in it until Sir R. Temple went so far as to recommend "the appointment of a Commission to investigate once more, and, as I should hope, finally the question of the relative valuation of gold and silver". Unfortunately in that age of abrupt and endless changes of these relative values, it was impossible for any Commission whatsoever to decide on the matter once for all and finally. But even apart from the question of rating, the inconveniences and trials of Bimetallism were sufficiently well known in that age; and, as admitted by Trevelyan, Mansfield, Laing and other eminent advocates of gold currency, it was impossible to avoid Bimetallism as at least a transitional stage. Naturally, they tried to make this period of troubles and trials as short as they could.

Hence we have a curious and significant parallelism in all these projects. The authors of all these proposals start by recommending a gradual introduction of gold currency, their avowed object being to have the

gold coinage as merely supplementary to the silver. Once, however, gold currency was introduced they knew they would find themselves on an inclined plane. Instead of gold currency being increased slowly, every effort would have to be made to increase it rapidly, and to seek refuge on the *terra firma* of gold mono-metallism from the trials of Bimetallism. Thus, though they all started with the notion of introducing gold as auxiliary currency, they were all driven forward by the logic of facts, and they all had to conclude with the early dethronement of silver. In a word, the dangers of Bimetallism and of the fluctuations of the values of precious metals made the idea of having gold as an auxiliary currency in India impossible during the latter half of the nineteenth century.

Nature of the currency and prices problems of the sixties.

It is only in the light of recent theoretical studies that we can appreciate the real causes of the phenomenon which Mansfield and Trevelyan were investigating. The leading causes of the monetary troubles of the sixties in India can be reduced to three. The first cause consisted of the highly favourable balances of trade due to the great value of the cotton exports from India during the American Civil War. It should also be remembered that, with so many countries of the world still under the Bimetallic regime, there was a tendency to unload whichever happened to be the cheaper metal at the time, on the East. The third and a more persisting cause was the large import of capital into India and borrowing from abroad. The borrowings of India between 1855-56 and 1869-70 has been estimated at 96 crores of rupees. Both these causes were working in the same direction and were causing large imports of silver, as also a rise of wages and of prices. As regards wages, a study made of wages of unskilled labour by Sir D. Barbour shows

a rise of 25 per cent. between the years 1855 and 1870 (1). Between 1861 and 1866 prices rose by nearly 50 per cent. and the circulation of rupees also increased largely by 77 per cent. during the six years.

These statistics are very interesting, in view of the recent work done by Professors Taussig and Viner relating to the rise of circulation prices and wages in Canada during the period 1900 and 1914 as the result of large borrowings. In Canada, too, as in the case of India, there was a large importation of precious metals and a rise of prices and wages. As Prof. Taussig has observed, these phenomena "serve to verify and confirm the essentials of the Ricardian theory of international trade more completely and in greater detail than any economic experience that has been subjected to scientific analysis" (2). The case of India in the sixties will furnish an interesting parallel to the case of Canada. Indeed the demand for currency in India was more insistent than in Canada, since in our country there was another cause working in the same direction as foreign loans, viz., the large favourable balances.

Causes of the failure of Trevelyan's proposals.

Of all these schemes for a gold currency that of Trevelyan had the best chances of success. True, its scope was limited by the Secretary of State, who did not agree to making gold coin legal tender but allowed them only to be received at the Treasuries at the ratio fixed by Trevelyan. The measure thus amounted only to the restoration of the position which had been abandoned in 1852. Nevertheless, the circumstances were then more favourable to the maintenance of a gold currency than they were going to be for decades to come. For, as Trevelyan had pointed out, a gold currency in India would have helped in some measure to

(1) Barbour, *Theory of Bimetallism*, pp. 110, 125-128.

(2) Taussig, *International Trade*, p. 233.

raise the value of gold which was still falling and to lower the rising value of silver. The world would have welcomed a step which would have, on the one hand, checked the rising gold prices to some extent, and which would on the other hand have assisted silver to maintain its place in circulation. As Sir R. Giffen remarked before the Fowler Committee, "in 1864-65 gold was supposed to be, and no doubt was comparatively abundant throughout the world, and India in particular had been the recipient for a good many years of very large quantities of gold." At the best, however, in the face of the great changes in the relative values of the precious metals, the Indian experiment in gold currency had no certainty of success; and such chances of success as existed were thrown away by the initial mistake made by Sir C. Trevelyan in fixing the value of the sovereign too low. The notification of the 23rd November 1864 directed that sovereigns and half-sovereigns should be received in the public Treasuries as the equivalent of ten and five rupees respectively and would be paid out again at the same rate unless objected to. Admittedly, this was a half-measure, and even so it was foredoomed to failure. For the sovereign was certainly under-valued at ten rupees, as it could not be laid down at Calcutta for less than Rs. 10-2-9. In fact, Sir C. Trevelyan had rendered his immediate object the use of sovereigns in India—impossible by mixing it up with other great objects like the securing of the advantage of the decimal system of coinage, and the forging of specially close trade bonds between India and Australia. Sir W. Mansfield well summarised the criticism of Trevelyan's measure: "It seems strange to force down a strange coin at a price which is not its true equivalent; in short, to bend certain physical facts of value in favour of a notion of decimal convenience and of relation to other portions of the British Empire".(1) Like his successor Sir R. Temple,

(1) Papers relating to the introduction of a gold currency in India, p. 95.

Trevelyan attached great, and as it turned out, undue importance to the schemes for the general acceptance of the decimal system and for a uniform international coinage which were at that time being formulated and discussed in Europe. Hence the ratio fixed by him was too low; and though it was not "so much too low as was supposed by persons cognisant only of European statistics", the only result of the notification of 1864 was the accumulation on the hands of the Government of a certain amount of gold coin for which there was no demand; and most of these sovereigns had at length to be sent out to England, only a small proportion having been taken out by the public. . . .

It needs to be emphasised that there were circumstances which made the problem of a suitable rating of the rupee in gold of vital importance for the success of a policy of the introduction of a gold currency into India. Any scheme which aimed at this object had to reckon with continual changes in the relative values of the precious metals. But, apart from these changes in the world markets, India had on its hands the difficulties arising from the local appreciation or depreciation of the value of gold. (2) Above all, every gold currency proposal put forward in the nineteenth century in India suffered from the great drawback that there were no gold resources or fund to assist in the task of pushing gold into circulation. Similar proposals in our days start with the advantage of being based on the resources of the Gold Standard Reserve which has been accumulated during the regime of the Gold Exchange Standard. In the absence of any such resources in the earlier period, many of the advocates of gold currency proposed various indirect ways of encouraging the coinage and circulation of gold. Thus, we shall find some of them anxious to raise the rating of the sovereign even to Rs. 10-8-0, while others would

(2) Strachey's Minutes, dated 30th January 1869, para 15 ; Mansfield's Minute dated 4th August 1864, para 31.

forego the seigniorage on gold, in order to induce a flow of gold to the mints. Far from giving such special facilities for the introduction of gold however, Trevelyan stultified his own scheme by under-valuing gold at the start.

Hence the attempt of Trevelyan to introduce a gold currency proved a failure. But circumstances are stronger than human proposals, and had the extraordinary trade demand for Indian products which showed itself upto 1865-66 continued, as also the abnormally favourable balances, nothing could have prevented the establishment of a gold currency in India. In order to envisage this possibility, we might refer to the balance of trade which was even higher in 1865-66 than it was in 1864-65. It is to be noticed further that our imports of silver reached their maximum of £18 millions approximately in 1865-66 and then fell to less than a third at once, while our net imports of gold did not decline proportionately. Consequently, looking at the decade following the year 1866, we find India taking an increasing proportion of gold and a smaller proportion of silver. The reason was that the world was not able to send to India such quantities of silver as our country received until 1866. A corollary of this situation is that if the conditions of world demand for our exports had continued as they were in 1866, and hence had the demand for money in India continued as urgent as before, a gold currency must have been forced on India. This possibility had been noticed by our currency authorities. Mr. R. B. Chapman, the Financial Secretary, wrote thus in 1872: "It may be admitted that if it (the abnormal trade condition) had continued, India would have been very soon driven to take much more gold than silver in payment for her exports. Silver, in fact, would not long have been forthcoming for remittance to the East at the same rate, and a gold currency here would very likely have become a necessity".(1) As it

(1) Note by R. B. Chapman, Financial Secretary, dated 27th March, 1872.

was, however, the trade demand of the world for India's products slackened, and brought down with it the increased local demand for currency which had made a gold currency a live issue. The subsequent discussion of the problem by the Mansfield Commission and by Sir R. Temple was infructuous, since they were proceeding on the assumption of a state of conditions which was rapidly passing away. The pressure for money had ended for the time being, and we shall hear of it again thirty years later (after 1898) when another great increase of the world's demand for our exports made itself felt.

In view of the above circumstances, and also of the dependance of the volume of a country's currency on its progress in trade and general development, one can scarcely understand the apprehensions of the advocates of gold currency that the note issue of India was in the way of their plans. One could conceive, of course, that a vigorous and progressive paper currency, formed on a comprehensive plan like Wilson's might have proved "a complete counter-blast to the gold agitation."(1) But, the then existing paper currency was admitted unprogressive, and "its circulation was principally confined to the areas adjacent to circles of issue". Its circulation in fact did not exceed eight crores. Yet we shall see it arousing hostility and jealousy on the part of many of the advocates of a gold currency.

Report of the Mansfield Commission (2)

Resuming our narrative, we find that in 1866 the favourable balances of trade were still high and the demand for the increase of the volume of currency was as yet insistent. Availing itself of a demand for gold currency on the part of the Bengal Chamber of Commerce, the Govern-

(1) Dr. Ambedkar, *The Problem of the Rupee*, p. 39.

(2) H. of C. Return 148 of 1868.

ment appointed the Mansfield Commission. Mr. Massey was then the Financial Member, and his views in favour of a gold currency are well set out in the Memorandum which he prepared for the Commission. As regards gold currency, of which he was an ardent advocate, he refused to recognise the failure of Trevelyan's half-measure as decisive. He expected the Mansfield Commission to "pursue their inquiry into the expediency of giving a further development to the experiment which has been partially tried. Two points, however, may be considered as determined. The one is, that nothing short of the recognition of the sovereign, or some other denomination of gold coin as a legal tender, will suffice, and secondly, that the result of this recognition must be, sooner or later, the establishment of the more precious metal as the ruling standard". Less zeal was shown by Mr Massey as regards the other branch of the work of the Commission—the enquiry into the operation of the Paper Currency Act. He pointed out that "the note circulation is principally confined to the area adjacent to the circles of issue", and that practically "the currency note is a convenient substitute for a hoondee or inland bill of exchange, but fails to fulfil its legitimate function as a substitute for and as auxiliary to the metallic circulation". Little anxiety was manifested for the increase of facilities for redemption of the notes: "The main condition of a paper money is its convertibility, and this being ascertained, its circulation will be rather retarded than promoted by provisions for its convertibility at numerous stages of its progress. If paper is acceptable to the people as a substitute for coin it will be adopted; if not, no regulations will force it into circulation". The Resolution of the 3rd February 1866, which appointed the Commission added that "it must be shown that paper has not proved and is not likely to prove a circulating medium adequate to the wants and suitable to the habits of the country before an endeavour is made to introduce gold in supersession of, or in addition to paper".

The Commission was presided over by Sir W. Mansfield who had distinguished himself by his writings as the foremost advocate of the cause of gold currency in India. Another member, belonging to the same school of thought, was Mr. G. Dickson, Secretary and Treasurer of the Bank of Bengal, and a close student of currency matters. Business interests were represented by the managers of two other leading banks of the country. But the name of Sir Henry Maine would alone suffice to render any Commission illustrious.

The deliberations of the Mansfield Commission are of considerable importance in the history of the Paper Currency of India. Its report stated that "the apparent failure" of that currency was not "a sufficient reason for despairing of its gradual extension". The great bar to the utility of the currency notes, and the factor which led to the notes being "depreciated at varying rates of discount" was the want of facilities for the encashment of notes. Various means were discussed for the removal of the prevailing mistrust of the notes. The preponderance of opinion was in favour of one universal note for all India to be readily convertible at the Presidency towns and at certain specified treasuries. There were others who advocated a separate note for each Presidency. Adverse criticism was directed against the prevailing arrangement of circles. The Commission recommended a consideration of the universal note idea in spite of the difficulty of its execution. It also supported Mr. Laing's original idea of employing banks as the best available means of agency for the circulation of the notes. As to the five rupee note, the majority of the Commission was against its issue. It is a convincing proof of the sincerity and unbiased zeal which the Commission brought to bear upon the study of monetary problems of India, that though it was appointed in an atmosphere not very friendly to the Paper Currency System, it made some

suggestions for its improvement. It also attributed the failure of the notes in supplementing metallic circulation to any material extent, to defects in the original arrangements as regards paper currency.

Coming to the subject of a gold currency for India the Commission argued for its introduction mainly on the ground of the general demand for it. The further argument that "the introduction of gold would facilitate the establishment of the currency notes" does not, however, sound very convincing. The Commission was for making gold legal tender, as part of the currency arrangements of India. It was argued that the rating of the sovereign at Rs. 10-4-0 was sound and scientific, and that the ten-rupee and five-rupee gold pieces should have the weight of 120 grains and 60 grains troy respectively. It was further proposed to issue gold coins of 15, 10 and 5 rupees respectively which "would find more favour in the eyes of the people than notes of like value".

As was inevitable under the prevailing circumstances, there at once arose a controversy regarding the correctness of the rating proposed by the Commission.(1) While Sir John Strachey held that "sovereigns are not procurable at Rs. 10-4-0", Mr. Dickson, who had been a member of the Commission, argued that "Rs. 10-4-0 is a sound scientific and conservative rating, in as much as if a higher relative value had been fixed, the opposite and grave mistake would have been made of over-valuing gold and driving silver out of circulation". The actual costs of shipment of gold to India had been falling, and with it the price of the sovereign in Calcutta had fallen from Rs. 10-12-0 to Rs. 10-7-0, and in Bombay to Rs. 10-6-9; and Mr. Dickson confidently expected it to fall further and soon to Rs. 10-4-0. As it

(1) Papers relating to the introduction of a Gold Currency in India, pp. 133 and 181-182.

turned out, General Strachey's calculations were the more reliable.

Proposals of Sir R. Temple for a gold currency.

The recommendations of the Mansfield Committee had little effect on the monetary policy of the country; for the conditions with reference to which the Commission had been appointed were rapidly passing away. It had been appointed with a view to the solution of the problem of a considerable expansion of the currency which had been urgent in 1866. As Mr. Massey had put it in his Memorandum," the increasing demand for Indian produce, the general extension of commerce, the outlay of capital on works of internal improvements render it more than ever necessary that further provisions should be made for an expanded circulation". But that particular epoch of abnormally large exports and considerable borrowings was fast drawing to a close. Whereas, between 1864 and 1866 the Chambers of Commerce were constantly urging an increase of gold currency or paper currency or of both, some years after, Sir R. Temple admitted that "at this moment no pressure is put upon the Government from any particular quarter". His minute of the 5th June 1868 should be consulted as to the further reasons which delayed aeion on the Mansfield Commission's Report. There was much controversy as to the "revised rating of the sovereign relatively to the rupee" especially in view of "the tendency of gold to rise in value". The question of the standard with reference to which gold pieces were to be coined in India was also being debated, especially as plans were then being put forward in Europe as regards a combined system of international and decimal coinage. There was an extensive propaganda for uniformity of coinage then being carried on in Europe and America, and in June 1867 a great international conference had assembled in Paris to work out general uniformity in the world's coinage. Efforts were also being made to per-

suade India to conform her proposed gold coinage to the prevalent projects of an international coinage. Under these circumstances, Sir R. Temple's conclusion was that, before declaring gold legal tender, "it would be better to await the effect of receiving sovereigns at the revised rating and of the coining of the proposed gold pieces at the mint". This led to the Notification of 28th December 1868 by which the rate for the sovereign was altered to ten rupees and four annas. The measure was, as General Mansfield described it, "avowedly of an experimental character and devised for the purpose of obtaining experience with regard to the actual relative values of gold and silver before the Financial Department can be in a position authoritatively to recommend a law embodying the legal tender of gold".(1)

But the same difficulties of the problem of rating the sovereign which had been fatal to the measure adopted by Sir C. Trevelyan were also in the way of the success of Sir R. Temple's notification of 1868. Admittedly the measure did not prove efficacious, and the prevalent opinion was that this was due to the fact that the rating in the notification was not scientifically accurate but "unreal, imaginary and infected with error". It was suggested that a rating based "upon the present depreciation of the value of gold in India" could only be futile. Sir R. Temple himself chose to attribute the inefficacy of the notification to the fact that "the state of exchanges prevailing since that time has not been such as to cause the importation of gold bullion". He also urged that it was in vain to look for any flow of gold bullion while gold coin was not legal tender. But, whether the aim of the notification was to introduce the sovereign into the currency of India or to obtain gold for coinage of new gold pieces, it was in either case a failure.(2)

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(1) Mansfield's Minute of 9th February, 1869

(2) Papers relating to the introduction of a Gold Currency in India, pp. 152-153 and 128.

It would appear from the documents relating to the ratio controversy that Sir R. Temple's error regarding the ratio fixed in 1868 was due in great measure to his reliance on the opinions of Sir W. Mansfield and Mr. Dickson on the subject. The former had been arguing since 1864 that the proper rate was Rs. 10-4-0 for the sovereign; but he was not aware that this rate, though an over-valuation of the sovereign in 1864, was yet an under-valuation in 1868. He disregarded in this matter the basic factor of the situation—the appreciation of gold. On the other hand Mr. Dickson was aware of the appreciation but believed that it was a temporary affair. As we shall see, the sounder views of General Strachey on the subject did not receive the consideration which they deserved. Finally, as Mr. Harrison has shown, the Finance Minister was unprepared for the consequences of his policy even had it been successful. "Gold not being legal tender could only be held with safety in the currency department as one-fourth of the metallic reserve. Directly if this limit was passed it would have become necessary to hold it as part of the Government cash balance. Difficulties would then have arisen if the price of gold had fallen". The author just quoted regrets that with the failure of Temple's experiment "the opportunity of obtaining gold at a moderate valuation passed finally away".(1)

To overcome the acknowledged difficulties of rating gold coins in silver and of inducing a flow of gold an ingenious and important proposal was put forward at the time by two able mint masters—Colonels Ballard and Smith. Their proposals attracted even greater attention a decade later. Their main idea was to contract silver currency in India by a heavy seigniorage on its coinage. As a result of this, gold currency in India was naturally expected to receive an encouragement. Another benefit expected from the measure was the maintenance of the rupee as the equivalent

(1) Economic Journal, vol. III, p.59.

of the tenth part of the pound sterling. Here was indeed an efficacious scheme which would have forwarded the cause both of gold currency and of uniformity of exchange. But, as it savoured of a "managed" currency, it was too far in advance of the time when it was promulgated. Sir John Strachey argued against the proposal on the ground that "the essence of the Mint Masters' scheme is that a gold currency shall be forced upon India by an artificial contraction of the silver currency. Having created a dearth of silver money it is hoped that the country will take to the use of gold. I cannot believe that such a proposal could ever be seriously entertained".(1) But time and experience are great teachers, and the views of the famous Strachey brothers gradually altered so far that by 1886 General Strachey himself seriously put forward a scheme for managed currency allied to that of the two mint-masters.

The failure of the Notification of 1868 did not damp the abundant energy of Sir R. Temple. He had the benefit of the advice of Sir W. Mansfield who has himself told us that he had been much consulted on the subject by Sir R. Temple (at the instance of Sir John Lawrence, the late Governor-General). The Financial Member had a still better adviser in the person of Mr. George Dickson, the Secretary and Treasurer of the Bank of Bengal. Indeed, the Minutes and letters addressed by Mr. Dickson to Sir R. Temple form the best commentaries on the comprehensive plan for the introduction of gold currency which the latter brought forward in 1872.(2) There were several new features in this plan of 1872, but perhaps the most distinctive one was that the idea of making the gold mohur the future legal tender, which was only latent in Temple's project of 1868, was put prominently forward in 1872. The shifting of the emphasis from the

(1) Strachey's Minute, dated 30th January 1869.

(2) Dicksons' Letters and Minutes forming accompaniments of Sir R. Temple's Memorandum, dated 19th June, 1872.

sovereign to the Mohur was rendered easier as "the prospect of some universal coin being adopted internationally" was fading away. As a result of this, Temple advanced "the opinion that if it were determined to have a gold currency we should mainly employ our Indian gold coins for that purpose".

Reading together Temple's Minute of 19th July, 1872 with the Minutes of Mr. Dickson, we note that there were to be a number of stages in "the introduction of gold currency which ought to be an object of gradual attainment." The first step obviously was to obtain a sufficient supply of gold in order to initiate the scheme. This object was to be attained by the receipt of sovereigns at Government Treasuries (either in payment of Government dues or in exchange for silver) and by the issue of currency notes in exchange for gold bullion tendered at the Mint. This was the best means of gathering gold resources that Temple and his adviser, could suggest; though they were doubtful as to the efficacy of the measure, for the supply of gold in the Indian markets was then inadequate, "former supplies having been either absorbed for other purposes than those of currency, or exported to foreign countries". If and when, sufficient gold was accumulated by these means, it was to be coined into ten-rupee gold pieces which were to be made legal tender. Finally when the ten rupee gold coins became so popular that they displaced the sovereigns, then the rupee might be made a token coin. Meanwhile there was to be the inevitable "transition period of double standard" as under the proposals of Mansfield and Trevelyan. Like them, Temple could only hope that the period of transition would prove to be a short one.

The weakest point of Temple's project for the introduction of gold currency—as indeed of all similar projects of that era—was about the determination of the relative valuation of gold and silver. That was, of course, the crux

of all proposals for making both metals legal tender simultaneously. What for example was to be the weight of the 10 rupee gold piece or the proper value of the sovereign in rupees? The selection and maintenance of a mint ratio in accordance with the market ratio is certainly the main difficulty of Bimetallism. The only solution that Sir R. Temple could provide was to suggest the appointment of a Commission to ascertain definitely what should be the rating or the relative value of gold and silver. It was, certainly, so far as it went, a better solution than the one propounded by Sir W. Mansfield which was "to adjust as closely as possible, the relative values of the two metals in coinage, and then leave them to fight the battle for supremacy".(1) But even a Commission's decision could not have avoided the necessity of a constant readjustment of the selected mint ratio to changes in market ratio. The one hope that Temple could hold out was that, if some lucky fluctuation of the market ratio poured a lot of gold into India, "the occasion would be taken to declare gold sole standard, and thus the effect of the double standard would pass away for ever".(2) He did not say what was likely to be the effect on India of being suddenly deprived, at that period, of a large proportion of its silver coinage, which was best suited for the size of all her ordinary transactions. Again, the contemporary action of France in suspending silver coinage, which was followed by a general scramble for gold, rendered any rush of gold in our direction impossible.

The measures suggested by Sir R. Temple in 1872-73 for a gold currency were turned down by the Governor-General-in Council by the Resolution of 7th May 1874. Some years later Lord Northbrook giving evidence before the Fowler Committee gave reasons for his decision in the matter: "Perhaps some member of the Committee may say, How is

(1) Mansfield's Minute of 9th February, 1869.

(2) Temple's note of 8th July 1873.

it, if you had this recommendation from Sir Richard Temple in 1872, that you did not adopt it? The answer is a very simple one. That was a time when gold was appreciating, and it was impossible to do it".(1) No doubt that was one reason for not carrying out the proposals; for the relative rise in the value of gold began somewhere about the year 1867, though it became much more marked in the early 'seventies.' Indeed, as far back as 1868, Sir R. Temple had himself drawn attention to the phenomenon unmistakeably, by observing that "the tendency of gold to rise in value which was remarked by Sir W. Mansfield in 1864, has somewhat declared itself since he wrote".(2) But there was another admitted defect in the proposals of Sir R. Temple—they contained no provisions guarding against the dangers from Bimetallism. That necessary feature of any scheme for the introduction of the gold standard into India remained yet to be developed. The dangers of the initiation of a double standard by India on its own were real and could be avoided only in one of two ways; either India could join in a scheme for International Bimetallism or, in the alternative, while both gold and silver coins circulated in India the silver rupee should be given an artificial value. This latter feature constituted the new and distinctive feature of the proposals put forward by Col. Smith for a gold currency in India.

Col. Smith's proposals for a gold standard.

Approximately about the year 1870, the old difficulties arising from the urgent demands for expansion of currency and the adjustment of abnormal balances of trade had come to an end. But a new problem of an even more baffling character had made its appearance due to the then "recent rapid changes in the relative value of gold and

(1) Fowler Committee, Q 8,447.

(2) Sir R. Temple's Minute of 5th June, 1868 (last paragraph.) See also Laughlin, *op. cit*, page 161.

silver". The Indian exchange had kept falling since 1870-71 with the fall in the value of silver, and the average loss by exchange during the period from 1871-72 to 1876-77 amounted to over Rs. 2½ crores per annum[1]. By 1876 the sudden fall of silver caused great financial trouble and anxiety, while trade was so hampered that the Bengal Chamber of Commerce advised the Government to close the mints and thus to sever the connection between the value of the Rupee and that of silver.

It was under these circumstances that Col. Smith, formerly a mint-master at Madras and Calcutta, brought forward his very ingenious scheme for a gold standard and currency. He was a person of consummate ability, and scientific insight and his proposals possess new and valuable distinguishing features. In the first place his was the first proposal for a frankly "managed" currency; as no less a critic than Bagehot observed in the *Economist*, under it Government would 'regulate' the currency of India and give it an "artificial value". But, further, it was exactly because under his scheme the Rupee had a higher value than its silver content that it avoided the admitted evils of the double standard; while all the earlier proposals for gold currency in India had been open to the objection that, under their operation, Bimetallism was a necessary transitional phase, Col. Smith could claim justly that he did "not propose a double standard at all; not for a single day".[2] We notice, again, that while the rupee was to be given an artificial value yet the currency was to be *automatic*; and Col. Smith was careful to point how if his ideas were adopted "the currency, will, in India be governed by the rate of exchange, and its supply in either one or both of the metals be automatic, and self-

(1) Note by Mr. R. B. Chapman, Secretary, Financial Department, dated 13th July, 1876.

(2) Col. Smith, *Silver and the Indian Exchange, Essay* 7, paragraph 16.

adjusted to the wants of trade".[1] It is also remarkable that he proposed the formation of a fund closely analogous to the later Gold Standard Reserve. Thus he proposed to sustitute gold for silver in the paper currency reserve, "with the view to its being available for export when required or employed in circulation whenever the time arrived for the gold coins to be declared legal tender". Combining in itself so many new features and ideas, and possessing so many anticipations of the monetary development of the future, we cannot wonder that the scheme of Col. Smith was widely studied and that it exerted great influence on the monetary development of India. On the one hand it assisted by its suggestions the working out of principles of the Gold Exchange standard. On the other hand, many later formulations and projects of gold currency for India are under great obligations to Col. Smith. Above all is to be valued his clear comprehension of monetary principles. To take but one example, his definition of a gold standard was far in advance of his time. As he observed "a gold standard may exist with any kind of currency provided the latter can only be obtained by the delivery of gold". He added that "a gold standard and a gold currency are not necessarily connected, and that a currency made of paper or of rupees might be based on gold, that is, upon a gold standard—without having a single gold coin in circulation".[2] Indeed, in his later writings he was disposed to postpone the adoption of a gold currency indefinitely in the case of India.

The basic principles of Col. Smith's scheme, which formed a transition stage in the development of monetary thought in India, deserve to be studied carefully. To begin with, he would utilize the silver currency at its full local value for all payments until they could be made in

(1) Col. Smith, *op. cit*, Essay 5, paragraph 74.

(2) Col. Smith, *op. cit*, Essay 2, paragraph 43; Essay 3, paragraph 12.

gold. But, further, silver coinage was to be stopped, and the rupee exchange was to be raised to the value of 2s. The practical exclusion of silver from the mints was to lead to "the spontaneous admission of gold into the currency, by the mere balance of trade only". Criticising the earlier gold currency projects like those of Trevelyan, Col. Smith noted that "the attempt to introduce and fix gold in India without stopping the coinage of silver for individuals would have proved a complete failure".[1] Gold was to be made legal tender "without, at any time permiting a double standard". It was only in the last stage, when gold coins became sufficiently abundant for all payments that silver rupees were to be made purely auxiliary tokens, and the Government was to undertake the obligation of converting the Rupees into gold. In the task of raising the exchange he also proposed to employ a manipulation of the volume and rates of the council bills sold.

The consideration that Col. Smith's proposals formed a great advance on the older projects for a gold currency, and that they also embodied a more correct notion of the gold standard and suggested the mechanism for its establishment in India, should not induce us however to neglect the difficulties that the proposals would have encountered in their application. There would no doubt have been much difficulty in providing additional gold for currency in a period of diminished production of gold and of a general scramble for procuring it. Moreover, the raising of the exchange would have placed additional though temporary difficulties in the way of obtaining the additional gold. Under such conditions of shortage of gold and hindrances in the way of securing a larger proportion of it for India, the suspension of the coinage of rupees, as proposed by Col. Smith, would have led to a serious monetary stringency for a fairly long time.

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(1) Col. Smith, *op. cit*, Essay 6, para. 22.

Influence of monetary theory and developments abroad,

Any study of the tendencies of monetary thought and development in India in the nineteenth century would be incomplete without a reference to the influence of contemporary theory and practice in currency matters in Europe. We have already observed how the publication of Lord Liverpool's great work influenced the Government of India, and led it to propose the abolition of Bimetallism in 1835. Nor was the measure of Lord Dalhousie in 1852 uninfluenced by the course of events in Europe; for after the gold discoveries of the era that metal was demonetised in Belgium and Holland. We have seen further how the controversy between the "Banking" and "Currency" principles in England had its parallel in the discussions which took place at the time of the inauguration of the Paper Currency System of India. While James Wilson was the protagonist of a system of note issue based on the Banking Principle, Sir C. Wood and—to a lesser degree—Laing were advocates of the "currency principle". The triumph of the "Currency principle" in the enactment of the English Bank Act of 1844 was followed by its similar triumph in India in 1861. Mr. Laing claimed that he was following "the opinion of Sir Robert Peel, Lord Overstone, Sir C. Wood and such a large preponderance of high authority, that it may fairly be called the 'orthodox opinion' as recognised in modern England". He expressly pointed to the fact that "a small minority of able men, among whom Mr. Wilson was one of the most distinguished, held strongly to the other view, and his currency scheme for India was an attempt to give it a practical effect on a large and comprehensive scale."[1]

The stimulus of the orthodox English Economics of the day can be traced also in the agitation for a gold currency in India from the time of Mr. Laing to that of Col.

(1) Laing's Minute on the Paper Currency Bill.

Smith. Both James Wilson and Laing argue that "if we had to begin a system of currency *de novo* the most convenient of all the various systems now in practice would be found to be that used in England". The latter went on to add that "if we cannot at once attain this object we ought, at least to approximate to it as nearly as we can". Among the authors quoted in the various minutes on gold currency we find Adam Smith, Chevalier as well as J. S. Mill who was cited to prove that there was a natural division of labour between gold and silver—the former being convenient for large payments and the latter for the smaller ones.[1] More importance was naturally given to the dicta of M'Culloch and Macleod who advocated a gold standard and currency. Thus M'Culloch had argued that "as gold has so many natural grounds of preference on its side the true plan is to make it the only standard." M'Culloch had also indicated "various circumstances which make it much to be regretted that an attempt should have been made to exclude gold from the currency of India. It would be good policy to re-introduce gold currency". On the other hand, Ricardo is scarcely mentioned in the course of this controversy until we come to Col. Smith who had read Ricardo to good purpose; and Smith's advanced views on the gold standard and its mechanism might be attributed on good grounds to that study. Since that time, however, Ricardo's has been the predominent theoretical influence in the monetary development of India—and it need hardly be said that there are few better guides in economic matters. Thus we shall find that the projects of Lindsay and of Probyn for monetary reform in India were based on the teaching of Ricardo; while both the Gold Exchange Standard and the Gold Bullion Standard are founded on Ricardo's suggestions.

It is also necessary to advert to certain contemporary monetary developments which certainly influenced the trend

(1) Sir R. Temples' Memorandum, dated 19th June, 1872.

of thought in India. One of these was the International Monetary Conference which met in Paris in 1867, at the suggestion of the Emperor Napoleon. Though its original purpose was to secure the uniformity of coinage throughout the nations, yet its deliberations certainly afforded a great stimulus to the extension of the gold standard, for "the almost unanimous verdict of this conference was that the single gold standard should be recommended."[1] But while, on the one hand, these deliberations strengthened the hands of the advocates of gold currency in India, yet, on the other hand, they were in the way of the early and timely adoption of the idea of gold currency by Sir C. Trevelyan and his successors; for these financial authorities deemed it proper to conform local action in India to the general movement in the same direction that was expected to follow soon.

The monetary developments which occurred in France and the United States consequent upon the gold discoveries of 1850 also encouraged the advocates of a gold currency in India. The French accepted the influx of gold which resulted from the relative fall in its value, and trade was carried on there mainly on a gold basis without any inconvenience. In fact, for the time being, France was virtually on a gold standard. As Octave Noel described the situation, "silver was at first less sought and then neglected by the public, until it naturally drifted to the private banks and from them to the Bank of France". In the United States, too, Bimetallism was virtually disestablished by 1853. These facts encouraged the advocates of gold currency in India, like Mansfield and Trevelyan, to make light of the dangers of Bimetallism, and to entertain the hope that perhaps in India, "as in France, the silver coinage—would of itself subside into a token coinage". In arguing thus, they minimised the great hold of silver on India, as well as the adaptibility of silver coin-

(1) H. B. Russell, *Monetary Conferences*, pp. 44—46.

age to the size of the great volume of monetary transactions in the country.

General features of the period 1835-1878.

Reviewing the general features of the period of 1835 to 1878, we find that by the beginning of that epoch India had solved the great problem of the uniformity of her currency, and had managed also to abolish that partial and provincial species of Bimetallism which had brought with it an unusual crop of difficulties. The *regime* of silver mono-metallism was successful for about three decades; but later, there was a combination of circumstances including large borrowings from abroad over a certain period, and a sudden and temporary increase of foreign demand for Indian products—which produced great difficulties in the adjustment of the large favourable balances of India. Silver with its decreased supply was inadequate to the task, while the new and inelastic system of paper currency in India could give but little help in the solution of the problem. It was perfectly natural, under these circumsances, to propose that a gold currency should be introduced as auxiliary to the silver currency; but there were a number of obstacles in the way of this desirable achievement. The complexities of rating the gold coin in terms of silver were formidable in that age of great and abrupt fluctuations of the relative values of the precious metals, and several of the proposals for introducing a gold currency foundered on this rock. Indeed, we had a long and vigorous controversy over the rating problem, which lasted some years. Then, again, the propounders of the various schemes for gold currency acknowledged that as soon as gold was made legal tender side by side with silver, the country would be in for all the trials and tribulations of contemporary Bimetallism. As Col. Smith put it,[1] "the chief difficulty seems to have been the existence of a large

(1) Col. Smith, *op. cit*, Essay 6, paragraph 32.

mass of standard silver coins which it was impossible to convert all at once into tokens; and therefore the apparently inevitable necessity for the concurrent circulation of standard coins of two metals;—a fact which induced many of the statesmen who had to deal with the question to consent to a double standard, at all events for a limited time.'' They were led through a fear of these dangers to project their ideas further, and to plan also for a gold monometallism and for the dethronement of silver. In formulating these ideas they were encouraged by contemporary English theory which looked upon the currency system of England as the ideal one. But in aiming at such a dethronement of silver they were far in advance of the circumstances and wants of India in their day. Later in the epoch we are considering, the appreciation of gold increased the difficulties in the way of the introduction of a gold currency into India, and account had also to be taken of the reduced flow of the precious metals towards this country for some years. Moreover, the circumstances with reference to which the gold currency proposals had originated had changed radically. The difficulties of the adjustment of the large balances in favour of India had disappeared for the time being; and a new problem—the Exchange problem—had emerged as the result of the startling changes in the production and in the relative values of the precious metals. It was this problem which occupied the attention of the currency authorities until the close of the nineteenth century.

LECTURE II.

THE MOVEMENT TOWARDS A GOLD STANDARD.

With the year 1872 there began abruptly a steady fall in the value of silver relatively to gold, which was of an unprecedented character, and which opened a new chapter in the monetary history of India. Not only had the production of silver increased while that of gold had fallen but the demonetisation of silver, which was then beginning exaggerated the changes in the relative value of gold and silver. As was observed by an official of the Finance Department, "on the one hand there is a severe pressure upon the remaining nations to follow the example of those who have already adopted gold....while on the other hand, the consequences to all alike of the adoption universally of a gold standard must be most serious". Both to India and to Europe the new monetary conditions brought intolerable burdens. In Europe a great fall of prices began soon after 1873. The unfavourable effects of that fall of prices on industry and the increase in the burdens of debtors, which were serious enough, were magnified at the time and eminent economists talked of these factors as "strangling the arteries of industrial life". To India it brought grave embarrassment of the finances, while the calculations of traders were baffled by the instability of exchange. Both in the East and in the West, the prolonged crisis produced new controversies, and new developments of monetary theory and practice. Europe and America were divided into opposed camps of Gold monometallists and Bimetallists. In India the main effect was to silence the propaganda for a gold currency for the time being; for it was obvious that any increase of demand for gold on the part of our country would lower gold prices still more,

would raise the value of the yellow metal and would thus increase the weight of our foreign obligations. This consideration was reinforced by the reduction in the supplies of gold which India could import during that period of trade depression. Consequently for India the main problem was to discover a system of gold standard which would make minimum calls on the gold supply of the world. Not that India was not influenced more directly by the bimetallic propaganda. Indeed, we shall find the Government of India and the commercial interests of the country placing their hopes alternately in the success of Bimetallism and in the adoption of a gold standard suited to the needs of the country. We have some minutes and memoranda of the day which might easily be mistaken for erudite treatises on Bimetallism, and others which might have assisted Mr. Lindsay in working out his great scheme. In 1878 came the despatch of the Government of India, which pointed unmistakeably towards the future Gold Exchange Standard. On the rejection of that plan, for some years, Bimetallic aspirations guided the proposals of our Government. Beginning with 1886, however, we see a return to the plans for closing the mint and for the adoption of a new standard.

What was true of India was also true to a great extent of the world. In the latter half of the 19th century, there had been a crop of dislocated exchanges, partly owing to the abolition of Bimetallism and partly through the depreciation of inconvertible currencies in several countries. The world had before it, as one alternative, Bimetallism which had it been adopted, would have stabilised many of the exchanges if not all. There was however another alternative; and the monetary reforms in the direction of Gold Exchange Standard ultimately sufficed to restore stable exchanges in many countries. As it was put by Nogaro, "during the last years of the 19th, and the opening years

of the 20th century most countries had successfully overcome the monetary difficulties which had resulted, in the first place from putting fiduciary currencies into circulation, and, secondly from the abolition of Bimetallism and the disappearance of a fixed exchange ratio between gold and silver".

To resume our narrative, we find that the Bengal Chamber of Commerce seriously considered the problem presented by the continued depreciation in the value of silver, and forwarded a resolution to the Government recommending not only the closing of mints to silver, but suggesting further that the import of coined rupees from any foreign port might be declared unlawful. The Chamber did not however go on to recommend the opening of the mints to gold. These proposals afforded an opportunity to review the whole monetary situation which produced the highly instructive despatch of October 13, 1876 and the Resolution of 31st July 1876. The Government was perfectly justified in its criticism and rejection of the suggested policy of merely closing the mints to silver, without any approach being made towards Bimetallism; for the mere closing of the mints would lead only to an appreciation of the Rupee and to a fall of local prices. As Indian prices had already been falling between the years 1866 and 1876 the proposal would have intensified the fall, and as a result would have depressed production in India, besides unsettling the equities between debtors and creditors. The resolution further pointed out that automaticity was essential to a sound system of currency, and that the mere closing of mints would destroy such automatic character as the silver standard possessed. The difficulties of the management of currency by government instrumentality were also dwelt upon. In view of the then prevailing state of monetary theory and practice, this hesitating attitude was a natural one.

The problem of how to deal with the matter on more comprehensive lines, should the value of the rupee become permanently low, was discussed in the despatch of 13th October 1876. In this despatch is embodied the first serious attempt to estimate the amount of coined rupees in circulation, and the cost of introducing a gold currency into India. All earlier projects had been very much in the air, and had proceeded without providing any statistical bases. The despatch began by stating that "roughly for every 1d. by which the sterling equivalent of the rupee falls below 1s. 8½d. we shall be compelled to improve by one crore of rupees the balance of our account". To prevent such losses, it was necessary to produce an enhancement of the standard of value. Such an enhancement it was shown might be effected in two ways—either by increasing the weight of fine silver in a rupee by say 20 per cent, or by a substitution of gold as the standard of value. Assuming that the coined rupees then in existence were about 200 crores, the cost of thus increasing the weight of silver in the rupee was estimated at about 40 crores. But it was also pointed out that "there was a lack of finality about the measure that made it as a monetary device vastly inferior to the adoption of a gold standard". On the other hand, the adoption of a gold currency would cost about 100 crores of rupees directly. Indirectly, indeed, the cost would be much larger, since the increased demand for gold would raise the value of that metal and would "operate directly to raise the weight of our net foreign obligations". In fact, the cost of a gold currency was prohibitive, and for the time, the idea of a change to a gold standard was rejected on the ground that it was "indefinitely costly". Such a transition, however, it was added, might become necessary in case all schemes of International Bimetallism failed to materialise. There remained the proposal to raise artificially the value of the rupee by increasing the seigniorage in silver. But at the time the

expedient was rejected, at least as a permanent measure, on the ground that it would be an "artificial" way of increasing the value of the rupee. We note that the despatch contained a very thorough and scientific preliminary examination of the different alternatives before the Government; we further remark the repugnance to the adoption of any "artificial" or "managed" schemes of currency which was characteristic of the time.

Bagehot's views on Indian currency.

A reference might be made here to Bagehot's articles on Indian financial topics—which were appearing at that time in the *Economist*—if only to emphasise the changes that have taken place in monetary theory and practice since the days of that great man.[1] It is also useful to turn our attention occasionally to the principles which had so far guided the currency policy of India. As a champion of the old orthodox school of theorists, which emphasised the virtues of an automatic currency, Bagehot fully approved of the action of the Government of India in 1876 in turning down the proposal of the Bengal Chamber of Commerce to suspend the coinage of silver in India. He believed that India was "irrevocably committed to a sole silver currency", and hence he was against any attempt towards the abandonment of silver mono-metallism by the introduction of a gold standard or Bimetallism or by its modification through the suspension of the rupee coinage. "No competent person can propose a demonetisation of silver in India and a substitution of gold for it, just at a moment when the price of silver has been thrust down by so strong an apprehension caused by such peculiar circumstances.—It would be to require the Indian Government to buy the largest amount of gold ever bought in the dearest market for gold, and to dispose of the largest

(1) Bagehot's book "On the Depreciation of Silver" pp. 52-53 and 64.

amount of silver in the cheapest market for silver that ever existed. The present financial position of the Indian Government is no doubt impaired by this sudden depreciation of the metal in which it receives its revenue but the remedy for a minor deficit would bring in, in lieu of it, a deficit of the first magnitude; it would be nothing else but financial ruin''.

As a champion and defender of the ''*Laissez-faire*'' school, Bagehot had distinguished himself in the controversy with the historical school as represented by Cliffe Leslie. Bearing this in mind, we can understand the position taken up by Bagehot as regards the currency controversy in India. ''The real remedy'', he observed, ''is to leave the great natural forces of trade to operate unrestricted. The true remedy for an enfeebled market is an access of demand, and in this case the laws of commerce, if not suspended or crippled by state interference, will produce that demand. The necessary effect of a depreciation of silver as against gold is to give a bounty on exports from India and the other silver-using countries to England....and the combined effect of this bounty on exports from India, and of this fine on imports into India, must sooner or later be an unfavourable balance of trade, and a consequent flow of silver to the East. A new demand of great magnitude will eventually relieve the silver market, if we only leave it alone.''

As we have seen, Bagehot was strongly opposed to the suspension of the rupee coinage as well as to the introduction of a gold currency. ''No one would'' he argued ''propose to arrest the coinage of silver in the East as a remedy for such a state of things, for this would only disorder the silver market still further''. It would produce also a fall of prices and a rise of the rate of interest; and here it is interesting to note that Bagehot anticipates some aspects of the later theory as regards the topic of

"appreciation and interest". His was also an attempt to deal with the problem of the influence of appreciation on production. "The fall in prices would make people think that they were getting power—and the 'contraction', as the Americans call it, would raise the rate of interest.... For the time, the first effect of an appreciation is not pleasant, and neither the Indian nor any other mercantile community which has been exposed to it has ever liked it". This last observation of Bagehot has never received such clear illustration as in the post-war history of India, and, indeed, of the world.

Since the days of Trevelyan, most of those who have recommended a suspension of silver coinage in India have also pointed to the similar suspension in France and to the establishment of a Limping Standard there, as a precedent. Bagehot was not impressed at all by this precedent. He contended that "the cases are not similar. In India, silver is practically the only legal tender; in France and Italy, it is one of three and in the rest of Latin Union, one of two. The main currency in the first two countries, which are by far the greater and richer part of the Latin Union, is inconvertible paper which is now really the standard, and not metal at all. And in the other countries gold circulates as well as silver, so that practically, silver is only a subordinate currency in the Latin Union, taking it as a whole. And the whole position is different. The Latin Union was a group of double-standard countries largely using gold, and the question for them is whether, they will give up their gold and become silver countries exclusively or whether they will demonetise silver and use gold as a standard only. This would be troublesome and costly, but still it could be done. But India has no problem to consider; she is irrevocably committed to a sole silver currency and therefore a similar attitude would in her case, besides being mischievous. have no meaning".

Character and importance of the Monetary Proposals of 1878.

The financial difficulties of the Government went on increasing, while the inconveniences to trade from dislocated exchanges were also accumulating since 1871. The loss on exchange had increased by nearly two-and-a-half crores, while the burden on the Import trade amounted to the imposition of a very heavy duty. Consequently, the Government of India came forward in 1878 with a proposal which was, in a way, the precursor of the future Gold Exchange Standard. In its despatch of 9th November 1878, the Government of India at last advanced boldly a proposal for a "managed" currency. In fact, it was the first Government in the world to entertain the idea of such a currency. The essence of its proposals was to maintain silver coinage at a rate much above its gold value—say, at the rate of 2s. In spite of the expected difficulties and inconveniences, it was declared practicable to maintain a gold standard "with silver coinage as the principal element in our currency, with a very limited gold coinage or without a legal tender gold coinage at all". A double instrumentality was recommended for maintaining the exchange value of the rupee. In the first place, the seigniorage on the coinage of rupee was to be so adjusted as to maintain automatically the value of the rupee in gold. At the same time, by receiving gold coin in payment of any demands of the Government a gold reserve was to be created in order to support the exchange. As the despatch put it, "the accumulation of a certain proportion of British gold coin in the currency reserve would give a most useful power to Government to meet any sudden or unusual pressure on the exchanges; and once more the Indian currency would have restored to it the power of contraction by the export of coin which it has practically long lost". It was only at a later period that Indian mints were to be thrown open to the coinage of gold, and, further, it was

not supposed that "the habits of the people of India in respect to the use of silver coin for the bulk of their transactions" would be modified. "Only a certain limited scope would be given for the introduction and use of gold coin".

In examining these proposals the first thing that strikes us is their resemblance to the future Gold Exchange Standard system. The accumulation of gold coin in the currency reserve, with the object of supporting the exchange and of contracting the currency, was an obvious anticipation of the analogous mechanism of the Gold Standard Reserve. The basic idea of the despatch, viz., the maintenance of a gold standard "with silver coinage as the principal element in our currency and with a very limited gold coinage or without a legal tender gold coinage at all" was obviously realised under the Gold Exchange Standard. The rupee was to be reduced under the proposals to the position of a token currency, and we note further that the proposals contemplated the establishment of "a self-acting-system under which silver would be admitted for coinage at a fixed rate as the wants of the country required", which was of the essence of the future monetary standard of India.

There has been quite a controversy about the merits and practicability of the above idea of "a seigniorage varying inversely as the gold price of silver".[1] The Herschell Committee, as a body, emphasised the administrative difficulties of providing "from time to time for the necessary alterations in such a varying seigniorage so as not to embarass trade or to encourage undesirable speculation". Yet, there were members of the Herschell Committee, like Mr. Leonard Courtney, who believed that "the action would be fairly simple, if the plan were fairly tackled". Nor are

(1) *Cf.* Prof. Gyan Chand's Memorandum submitted to the Royal Currency Commission of 1925.

there wanting more recent advocates of the proposals. The Herschell Committee did indeed argue that the proposal regarding the seigniorage "was in fact an indirect method of attaining the end which the Indian Government propose to attain by closing the mints". But, in observing this, the Committee overlooked the most important merit claimed for their proposals by the Government of India of 1878. The proposed plan would give the Government no power to add to the currency by the coinage of silver and all fear of an inflated token currency would thus be removed". As between two systems of managed currency —managed with equal ability and integrity—preference is to be given to that one which *appears* more automatic to the public.

With all their undoubted merits, the proposals of 1878 were rejected by a committee containing such eminent men as Mr. Arthur Balfour (now Lord Balfour), Mr. Giffen, Sir Louis Mallet, Mr. (later Lord) Farrer and Mr. (later Lord) Welby. As Sir R. Giffen informed the Herschell Committee in 1893, it was he who prepared the memorandum which guided the deliberations of the Committee and formed a part of its proceedings. The foremost argument in that memorandum against the Government of India's proposals was that they "introduced a managed currency- a currency that you had to manage; it would not be an automatic metallic standard such as was recognised to be the best".[1] In our days, we recognise that all currency systems need a great deal of management, and that the old idea of currency systems without human purpose or contrivance was a myth. But in 1879, to say that a currency system was a managed one was quite sufficient to secure its condemnation at sight. Another objection which Giffen advanced against the proposed system was that, under it, the provisional state—

(1) Evidence of Sir R. Giffen before the Fowler Committee, Q. 10,025—50.

during which there was to be no gold in circulation—might conceivably last a long time. Finally, as he admitted later, he believed in 1879 that the depreciation of silver was only a temporary affair, and that hence no such change of monetary standard as had been proposed by the Government was at all necessary. He recognised fully that a very serious depreciation of silver did ultimately take place, but he defended his former position on the ground that such depreciation could not have been possibily forseen in 1878-79.

The fact was that Sir Robert Giffen took an unduly optimistic view of the difficulties which confronted the Government of India; and further, as an opponent of the Bimetallists, he was bound to say that the depreciation of silver was only a temporary phenomenon. In arguing that the depreciated silver would be absorbed by the East, the mono-metallists forgot to take into account the depression of trade and its effect on Indian balances of trade. Further, Giffen, exaggerated the potentialities of additional taxation in India, and he believed that the loss on exchange could be met by fresh taxation. Such as they were, however, his arguments carried the day, and the Committee turned down the proposals of the Government of India. Consequently, that Government was compelled to turn to International Bimetallism as the one possible remedy for the difficulties of exchange and finance.

India and the Bimetallic movement.

For several reasons, the Bimetallic controversy and propaganda deserve the serious attention of the student of Indian Economics. In the first place, India loomed very large in the general controversy, and both the opponents and the advocates of Bimetallism built their hopes, to an important extent, on the action they expected India to take. Walter Bagehot and other critics of Bimetallism argued that the fall in the value of silver was only a temporary phenomenon and that it would be soon remedied

by the absorption of silver by India and other countries of the East. Their contention was that the fall of silver would enable the western countries to give more silver than before for each unit of products exported from India and the East. This state of things would naturally give a bounty to exports from the silver-using countries in general, and the consequence would be a general increase of exports from the silver-using countries leading to an absorption of surplus silver by India and the East. It was supposed that as the result of this process the old ratio between gold and silver would be restored without any necessity of resorting to Bimetallism.[1] It was on this account that the topics of the absorption of silver by India and other countries of the East and of the growth of exports from them were of such absorbing interest in the Bimetallic controversy. If, as the gold mono-metallists hoped, exports from silver were encouraged by the bounty and silver were exported to them and Indian prices rose as a result, the problem of the withdrawal of the surplus supplies of silver from Europe would have been automatically solved.

As against these contentions the champions of Bimetallism advanced other arguments, which were also based on expectations regarding the monetary policy and conditions of India and the East. Their first contention was that it was gold which had risen in value and not silver which had fallen in value; and this they tried to demonstrate from the course of prices in India and in the East. In the second place, they urged that, since 1873, the East, and especially India had been absorbing gold and silver in comparatively moderate quantities only, and hence the hope entertained of unloading the depreciated silver in that direction was a vain one.

We have to discuss these preliminary issues briefly before giving an account of the part played by India in the

(1) Barbour, *Theory of Bimetallism*, pp. 100—101 and 134.

Bimetallic movement. And we shall first examine the time-worn theme whether it was gold that had appreciated or whether silver had depreciated. As regards this particular position, both sides were right to a certain extent and in a certain sense. As we shall see, Gold had undoubtedly appreciated to some extent owing to a temporary fall in its production; but, in the main, the fall of gold prices was due not to any monetary cause but to a veritable industrial revolution after the sixties and to a vast increase of the volume, production accompanied by a great lowering of costs of production and of freights. As Arnaunè observes, "the fall of prices since 1870 appears to us as due for the most part to new applications of science to industry. We admit that the effects of this economic revolution have been rendered more impressive by the fact that they were not diminished as after 1850 by any reduction in the value of gold—that metal having reconquered at least partly its former purchasing power".[1] Such was also the opinion of the Gold and Silver Commission, which argued that "the greater part of the fall has resulted from causes touching the commodities rather than an appreciation of the standard". That was also the conclusion of an authority who is equally well-known in the spheres of Economic theory and Economic history. In his great work on "the Silver situation in the United States", Laughlin argues that "the extraordinary improvements in the production of commodities do seem to have an important bearing on the question in hand". The period witnessed, in fact, the liquidation of the crisis of increased production; we had at once a simultaneous increase in supply of commodities, a more intensified industrial competition and a fall of freights. All these numerous factors contributed largely to the general fall of prices after 1872.

More recently, the topic of the depreciation of silver has had fresh light thrown on it from different angles by

(1) Cf. Arnaunè, *"La Monnaie, le Credit et le Change"*, pp. 61—67.

Professors Nogaro and J. W. Angell.[1] Nogaro considers the depreciation of silver during the period 1867-72 as due to other causes than the fall in the value of the same metal which took place after the year 1873. Before the year 1873, silver was allowed to be minted in bimetallic countries for the benefit of private individuals. The result was that whenever England, for example needed silver to remit to India, she had only to send gold to France and exchange it for French silver, while India used her silver to purchase French gold for the settlement of balances due to England. Until after the middle of the century, Prof. Nogaro finds, the sums thus due and receivable came out substantially equal''. But in the sixties India required comparatively smaller shipments of silver; and in other countries too, the position of silver was shaken, with the result that the demand for silver for settling balances of trade was reduced. The earlier large scale demand for silver for settling the balances, and the possibility of sending silver to bimetallic countries to be exchanged for gold at a price corresponding to the legal ratio obtaining there, had combined to fix a minimum price (and also a slightly higher, maximum price) for silver. Circumstances however changed all this and this suppression of the freedom of coinage of silver (as distinguished from the suspension of coinage) was an important contributory cause of the decline in the value of silver. Prof. Angell has pointed out further that ''improvements in monetary and banking technique steadily diminished the demand for so cumbrous a currency'' as silver; as he adds, ''the various demonetizations merely emphasized, and for the time being increased a fall which was in any event inevitable''.

It cannot be denied, however, that to a certain extent there was a direct appreciation of gold, and not a mere resultant fall of gold prices—through the reduction in the

(1) Cf. Angell, *Theory of International Prices*, pp. 420—422 and Nogaro, *Modern Monetary Systems*, pp. 29—30.

production of gold during the period from 1871 to 1885.[1] During this period, the supply of gold fell below what it had been in the years stretching from 1850 to 1869, while the demand for gold increased, especially owing to the wants of the United States for gold from the period 1879 to 1887 with the object of realization of the resumption of cash payments. But both the extent of this appreciation of and of the growth of demand for gold was exaggerated by the Bimetallists; for we observe that the reduction in the supply of gold was only temporary. while the growth in the demand for it was compensated by economies in its use—by the growth of deposit banking and by the rise of cheques and notes.

On the other hand, the depreciation of silver was a much more serious and permanent matter. While the appreciation of gold was a short-period phenomenon, the depreciation of silver was a long-period phenomenon, since over a couple of centuries silver had been falling in value, gradually, in relation to gold. While silver was losing favour with the great commercial nations, its production was growing by leaps and bounds. Its production was in fact doubled between 1860 and 1874, rising from 30 million ounces to 60 million ounces. The production again doubled itself between 1874 and 1888 when it was 120 millions. Once again its production nearly doubled itself in 1913.[2] There were other changes too on the supply side of silver; for silver was becoming a by-product, and even the fall of the value of silver had not been able to have its full effect on its production. It is, however, the changes on the demand side which were even more prolonged and serious. As we have seen, even before silver depreciated, opinion in the leading countries had veered round on the side of gold.

(1) Taussig, *Silver Situation in the United States.*

(2) Cf. Barbour, *Standard of Value*, p. 140; and the evidence of Professors Carpenter and Cullis before the Indian Currency Committee of 1919.

Thus there existed special factors both on the long period supply and demand sides of silver which were bound to lead to its depreciation, though these factors were not so clearly discernible during the heat of the Bimetallic controversy, as they are to us in the light of later statistics.

Thus, while the Bimetallists were in the right in their main contention regarding the benefits of International Bimetallism, we find that they over-emphasised the appreciation of gold and passed lightly over the long-period influences leading to a depreciation of silver. Nor were they successful in their efforts to prove that silver was a more "honest" metal than gold, and a better standard of value as regards equities between debtors and creditors. Their case cannot be said to be proved, even if it is shown that during the disturbed period which followed 1873, silver prices in certain parts of the East were more stable than prices in certain gold countries. For the international distribution of silver was then an abnormal one, affected as it was by such factors as demonetisation and the peculiar conditions affecting the balances of trade of countries due to the general depression. Had trade been governed by normal conditions, and had the East been absorbing silver in large quantities the price situation there might have been very different from what it actually was.

There was a great deal of controversy as to why much more of the depreciated silver was not absorbed by the East. It was shown that "from 1855-56 to 1865-66 India imported annually 108 millions of rupees." But this was largely due to special causes like continued borrowing and very favourable balances of trade. In later years the imports were only slightly above Rs. 30 millions annually.[1] Quite a number of theories were advanced about this unexpected reluctance on the part of India to absorb more of the depreciated metal. Prof. Pierson had argued that India

(1) Barbour, Bimetallism, pp. 110—112.

could not absorb more silver because it had been saturated with silver during the sixties. It was obvious, however, that unless India was in a position to export more commodities to Europe she could not import more silver. Her opportunity for large exports of goods and for corresponding imports of silver had come during the Crimean War and the American Civil War, and she had availed herself of it. But after 1870 when Europe and America were in the grip of the great depression, they could not import more of Indian products, and hence India could not absorb more silver, even though it had fallen in value. This trade aspect of the matter was not sufficiently emphasized in the course of the controversy on Bimetallism.

The Monetary Conferences of 1878 and 1881.

At the Conference of 1878 Goschen made a strong appeal against pursuing any course which would weaken the position of silver and prevent it from acting as the ally and auxiliary of gold. In his representation he showed why the interests of India as a country using silver currency were entitled to special consideration on the part of the countries represented in the Conference. India had been bearing the losses due to the depreciation of silver without making any attempt to close her mints to that metal. "India had done more than any other country", he declared, "to maintain silver, had allowed it to take its natural course, while other countries had been shutting their doors; and the Indian government had suffered a great loss, the merchants from fluctuations in values, and public functionaries from the depreciation. Had the example of other countries been followed in India, silver might have fallen an additional 10 or 15 per cent.; so the *laissez faire* policy pursued by India had done more than anything else to keep up the value of silver. If, however, other states were to carry on a propaganda in favour of the gold standard and of the demonetization of silver, he feared the

Indian government would be obliged to reconsider its position, and to take measures similar to those taken elsewhere. In that case the scramble to get rid of silver might provoke one of the gravest crisis ever undergone by commerce''.[1] That Conference however failed to reach any definite results owing mainly to the course of events in Germany and the United States. Germany would not even participate in the Conference as she was busy unloading her silver. The passing of the Bland-Allison Act in America, just before the conference met, was another hindrance to a general settlement, for it gave rise to the idea that America wanted to anticipate the adoption of International Bimetallism and desired to maintain a national scheme of bimetallism at the ratio of 16 to 1 irrespective of the ratio prevailing in France or elsewhere. Had any European nations desired to re-open their mints to silver they would have had to adopt the American ratio and to recoin all their silver. Under such circumstances, an agreement as regards Bimetallism was not to be expected.

It was in the work of the Monetary Conference of 1881 that the Indian Government manifested the greatest interest and placed high hopes. Its monetary proposals of 1878 suggesting the closing of mints to silver and the introduction of a gold currency had been rejected by the Treasury in 1879; and thenceforward, for some time, it was in the direction of Bimetallism that the Government of India sought for relief from its financial difficulties. Indeed, the trend towards Bimetallism might be noted even in the despatch containing the proposals of 1878. It was pointed out therein that ''the measures which we have proposed, would place the currency of India in a position in which the future possibility of an alternative standard would be left open''. It is noteworthy that many of the financial authorities of India were inclined to favour Bi-

(1) Henry B. Russell, *International Monetary Conferences*, p. 226.

metallism. Sir E. Baring, (later, Lord Cromer), the Financial Member, expressed himself as favourable to Bimetallism, and in a very learned despatch of 19th April 1881 he tried to confute the views of Sir R. Giffen and to show that the later had "underrated the probability of a fixed ratio between gold and silver being maintained through the agency of a universal bimetallism". His own opinion was that India should preserve its liberty of action and stand out of any Bimetallic experiment, but at the same time should try to ensure the success of any such experiment indirectly by engaging to coin silver in unlimited quantities. Bimetallism in India was also fortunate in securing zealous champions in Mr. R. B. Chapman who was the Secretary to the Government of India in the Department of Finance and Commerce from 1869 to 1881, and in Sir T. C. Hope. But the ablest advocate of Bimetallism in India was Sir D. Barbour—a financier of the first ability who was equally at home in monetary theory and practice.

The discussion was started by a memorandum on an International Bimetallic Standard written by Mr. R. B. Chapman at the request of the Financial Member.[1] In that memorandum, it was argued, that the monetary disturbances were due to the appreciation of gold and not to the depreciation of silver. "While the value of both metals had risen the value of gold has risen more than that of silver". India, it was added, might expect two great advantages from an International Bimetallic standard—a removal of the fluctuations of exchange which were causing inconvenience to trade, and a "vast improvement of the stability of the general standard measures of value which is of such supreme importance". The conclusion was that "if America, France, Germany and India were to unite

(1) See Memorandum, dated 2nd June 1880 by Mr. R. B. Chapman on an International Bimetallic Standard measure of Value'

with this object, the desired reform would be effectually and permanently accomplished, and that it might even be possible to dispense with the co-operation of Germany. The Government of British India, it was suggested, need not hesitate to become a party to such a union to which it might be expected that other nations would quickly adhere. The Government of India, on the other hand, should not join any convention to which France was not a party. Prevailing circumstances imperatively demanded concerted action between France and India.

Sir Evelyn Baring, the Finance Member was not however, willing to go so far as this. He argued in his Minute of 19th April 1881, that "India should for the present only engage to coin silver in unlimited quantities and to continue the use of silver as legal tender for debts of any amount for the period the proposed convention remains in force." He was anxious as far as possible to preserve liberty of action for India, and the message to the Secretary of State recommended that India should engage to coin silver in unlimited quantities, "reserving the right of also coining gold freely and making gold also legal tender if hereafter Government thinks fit." It will be seen that the majority of the Council was in earnest about joining hands with the Bimetallists, and proposed to make concessions to them—the main dissentient being Lord Ripon. He had no belief either in Bimetallism or in the policy of making gold legal tender in India. However, the majority had the satisfaction of noting that the instructions given to the Indian delegates to the conference of 1881 were in accordance with their suggestions.

There can be no doubt that, as a body, the Government of India was serious and earnest in its advocacy of Bimetallism. The Financial Secretary to the Government, Mr. Barbour, was indeed a distinguished advocate of Bimetallism. Another very zealous advocate was Sir T. C.

Hope[1] who was Financial Member of Council in 1881-82. He thus summed up the views of the Government of India: "The recommendation that was made by the Indian Government, I think in 1879-80 especially, was that, if England did not think proper to alter her own system she should allow India as a separate country to act in conjunction with the other nations of Europe, in coming to such an agreement as they all might think feasible under the circumstances". The Despatch of the Government of India dated 10th June 1881 also expressed the view that "if, for instance, the United States, the Latin Union and Germany were prepared to join, we should think the combination sufficiently strong to justify us in joining also".

The Conference of 1881.

"In interest and importance" says the historian of these Monetary Conferences "the conference of 1881 surpasses others in the Bimetallic series. It took place at a time when the doctrine of International Bimetallism had apparently reached its highest practical development. Never before or since have so many states affirmed its practicability, or has there been such a general desire to accomplish something". Nevertheless, the result of the Conference was a great disappointment to the Bimetallists. The cause of Bimetallism was argued vigorously by the representatives of the American and French Governments which had invited the Conference. America had at heart her silver interests, while France was being flooded at the time with silver coinage. Their warm advocacy of Bimetallism can therefore be easily understood. Far different was the position of England and Germany; they were both interested in keeping up their Gold mono-metallism, and were only willing to make relatively small concessions in order to keep up the price of silver. Of these concessions, the one proposed by England was to the effect

(1) Sir T. C. Hope's evidence before the Herschell Committee well describes the hopes and disappointments of Indian Bimetallists. (Q. 2,230—2,237).

that the Bank of England would exercise its option of keeping one-fourth of its reserve in silver, on condition of the mints of other countries being opened to silver. The concessions offered by Germany were much more illusory. The three so called concessions that Germany was ready to make amounted to but little—being either what she had been already compelled to by "the force of circumstances and in her own defence to adopt as a policy, or what appeared to the Government as possible aids in ultimately carrying out its programme of the gold standard". Among these was the suspension of the sales of her silver, which was already a *fait accompli.* The representatives of some smaller European countries expressed sentiments far more favourable to Bimetallism. Thus Dr. Pierson, who represented Holland, signified his conversion from mono-metallic doctrine to the faith of International Bimetallism. The delegates of Italy too associated themselves with the declaration of the representatives of France and of India on the subject of the necessity of raising the value of silver, and of establishing a fixed ratio between the two metals".

Speaking on behalf of India, Sir Louis Mallet pointed out that India had done much single-handed to maintain the value of silver. As India had been the victim of the policy of other countries, he argued that it was entitled to enter a claim that other countries should endeavour to keep up the value of silver. As against the representative of Belgium, he maintained the scientific basis of Bimetallism and the probability of its success. Through Mallet the Government of India offered to bind itself to maintain the existing system of free coinage of silver during a definite period, on condition that a certain number of the principal states of the world would join to keep up free coinage of silver at the rate of 15½ to 1.[1]

In spite of such support for the bimetallic proposals, the Conference of 1881 was not a success. It was adjourned

(1) Henry B. Russell, *op. cit.*, pp. 295—296.

in April 1882 and never reassembled. But the difficulties of India as regards trade and finance due to the continued fall of the price of silver were such that the Government of India put forward again the idea of a Monetary Conference. In the despatch of 2nd February 1886 the Government of India pointed out that its financial position was then no better than it was in 1874-75; that the fall in the exchange value of the rupee had imposed on Indian finances "a burden of nearly equal magnitude with that which has been thought necessary for the defence of India on account of the approach towards her frontier of one of the great military powers of Europe"; that rumours regarding the probable appeal of the Bland Act had caused a further fall of exchange, so that India could not count on obtaining in 1886-87 even an average of 1s. 6d. per rupee; and that, in this way, the state of Indian finances depended upon "the balance of political parties in regard to the currency of a foreign and distant country". Consequently, the Government of India considered it desirable that an attempt should be made to bring about a renewal of the international discussion on Bimetallism. But, this proposal was turned down by the Lords Commissioners of Treasury who argued that nothing had transpired which could induce a departure from the passive attitude taken up by the English Government in 1881. The Commissioners also urged that the loss sustained by the Indian revenue on the Exchange had been far more than counter-balanced by the gain from the stimulus which the fall in the value of silver had given to the Export trade of India. They also maintained that the unfavourable condition of Indian finance was due to the alarming growth of expenditure. The Government of India, in its reply, pointed out that the development of Indian trade and the steady increase of Indian revenue were due not to the fall in exchange, but to quite different factors, like a succession of good harvests, the improvement of communications in India and

to the cheapening of the cost of sea transport. It was also shown that the growth of expenditure was inevitable, being due mainly to construction of railways required for defence and for insurance against famine.

But by time that the Monetary Conference of 1892 was convened, the interest of the Government of India in the Bimetallic movement had been greatly diminished. Sir D. Barbour had in fact already formed his plan for the adoption of a gold standard for India and had placed it before the Herschell Committee. For, it was known that if a conference failed to inaugurate International Bimetallism, it would soon be necessary for the United States to decide whether to accept a silver standard or to stop the extraordinary and futile purchases of silver, and to repeal the silver legislation. That step would at once create a serious danger for India. As Sir D. Barbour observed in his Budget speech of 1891-92, "in case of necessity the gold standard could be introduced into this country, and that if America altogether abandons silver, it would probably be best that India should change her standard of value. The risks would be considerable and the sacrifices heavy, but almost anything would be better than to accept violent and continual fluctuations in exchange as our inevitable lot for all time, with the prospect of a fall in the value of silver of quite indefinite amount".

Nevertheless, the Government of India welcomed the invitation to the Conference of 1892, though it expressed its regret that it was summoned only to consider the question of the more extended use of silver as currency and not to decide the problem of International Bimetallism. It even went so far as to suspend the proceedings of the Herschell Committee "in consideration of what is due to the deliberations of the present Conference".

But at the Brussels Conference the advocates of Bimetallism had little chance of success. France, which had

vigorously pressed the claims of Bimetallism in 1881, had now changed her mind. As her representative observed, "France under present circumstances has no cause to complain of her monetary situation". It boasted now of being in possession of the largest quantity of money both in gold and silver. In a word, she had sufficient gold, and was not going to increase her coinage of silver—at any rate not without obtaining suitable compensation. Nor were other important countries of Europe more favourably inclined to Bimetallism. The representatives of "Germany, Austria, Hungary and Russia practically doomed the Conference to failure by stating that they were prohibited by their instructions from debating or noting upon any resolution whatever". Germany declared itself satisfied with its monetary system, and hence unable to modify it.

The representatives of India made a clear and straightforward declaration of the policy of this country. They asserted that "the only satisfactory solution would be the adoption of international Bimetallism in which India would join the Latin Union and the United States". If the adoption of a plan submitted to the Conference renders probable the maintenance of a relative stability in the price of the metal, it is not likely that the Government of India would close its mints to silver. Even if the plan should meet with only partial, but sufficiently important adhesion the Government of India, without relinquishing its liberty of action, would be disposed to buy silver, or to permit the coinage of a fixed quantity of silver—not less than fifty million rupees a year—during the entire duration of the arrangement". Having thus declared in clear and unmistakable terms their own views, the delegates of India desired the representatives of other countries to make categorical declarations of their views on the subjects—but in vain.

For there was never much chance of an agreement being reached at the Conference as regards International Bi-

metallism. Each country would no doubt have welcomed the increased use of silver, but only at the cost of other countries. The economic difficulties in the way of any agreement were formidable enough. There were difficult questions as regards the ratio to be fixed and of possible vast remintages of silver coinage; and there were risks involved in the matter of securing permanent adhesion by nations to any agreement reached. There were also possibilities of such agreement being undermined by underhand manoeuvres favouring the coinage of gold. When to all these economic difficulties we add the intense political jealousies and dislikes we can see how improbable was the adoption of International Bimetallism.

As Dr. Bruno Moll (Professor at Leipzig University) has recently observed in his work on "Recent Monetary Theories",[1] two factors combined to seal the fate of silver mono-metallism and of Bimetallism during the four decades which preceded the world-war. The first was the great and steady increase in the production of silver which would have rendered extremely difficult the fixation as well as the maintenance of any particular ratio between gold and silver. The second factor consisted of the increasing trade relations and economic intercourse of nations which necessitated the utilisation of a common medium of payment. The growing volume of international trade required for its convenience as well as progress a single metallic medium of exchange. Dr. Moll notes and emphasises as a symptom of this general and persistent tendency towards gold—the change going on in the Latin Union both before and after the great war.

Nor should we, in justice, shut our eyes to the real apprehensions which prevented the statesmen of the day from embarking on International Bimetallism. As Helfferich has pointed out, "if the agreement ceased to operate

(1) Cf. Dr. Bruno Moll, *Die Modernen Geld-theorien*, pp. 32—36.

either because one or the other of the parties did not keep loyally to its provisions, or because for inherent reasons, a bimetallic system could not be permanently maintained, then the position of all those states, which at the beginning of the agreement had enjoyed a secure gold standard currency, would at the end of it be substantially more unfavourable." The silver coins struck during the operation of the agreement would be a source of continued responsibility to the states concerned, and would constitute a threat to their monetary systems.

General Strachey's Currency Proposals (1886).

As the expectations entertained from International Bimetallism faded, the monetary policy of India began to be directed more and more towards the other method of avoiding the difficulties of exchange and finances—that of closing the mint to silver and introducing a gold standard. Already, as we have seen, the Government of India had proposed the measure in 1878; and the idea was revived by General Strachey in 1886, with important modifications.(1) The value and significance of the proposals of General Strachey have not so far received due recognition; but they form a remarkable anticipation of the Herschell Committee's proposals, and constitute an important step forward in the policy of introducing a gold standard suited to the requirements of India. They also show an exceptionally clear understanding of the consequences of closing the mints and of thus rendering the rupee a token coin. General Strachey's ideas were adversely criticised at the time by Sir D. Barbour; but then, admittedly Sir David was for many years "a strong opponent of any attempt to introduce a gold standard into India", and it was only the course of events culminating in the proposals to repeal the Sherman Act in 1890 that shook his conviction that "Bimetallism afforded the best solution in the interests of India".

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(1) See Memorandum of General Strachey, dated the 31st March, 1886.

While General Strachey aimed at the adoption of a gold standard by the suitable regulation of the coinage of silver in India, he was also aware that "proper provision should at the same time be made for the automatic expansion of currency to meet the requirements of trade, and precautions should be taken against inflation from arbitrary action on the part of the Government". Thus we find that, as regards some aspects of the coming gold standard system, General Strachey looked ahead not only of the Herschell Committee but even of the Fowler Committee. He proposed that the law which required the mints to coin all the silver brought to them should be repealed; but that so long as the mints were closed against the unlimited tender of silver, they should be open to the tender of gold; that is to say, that any one could obtain a fixed number of rupees in exchange for a fixed weight of gold. The gold would not be coined but would merely serve as a medium by which to measure the value of the rupee. Here we have a marked advance on the project of 1878 with its somewhat cumbrous proposals regarding the graduated seigniorage of silver. We also note an anticipation of the Herschell Committee's recommendation as regards the receipt of gold at the mints—a measure which defined the superior limit of the value of the rupee. This procedure would be less inconvenient than the older idea of fixing a graduated seigniorage, even though the results would be the same. For, it was added, "the necessity for the tender of the whole quantity of gold could obviously be avoided by the Mint receiving silver bullion sufficient in weight for the coinage of the required number of rupees, and only requiring in gold the excess value of the rupees, reckoned at 13 per sovereign, over their bullion value as silver. This excess value would virtually become a charge analogous to that for coining, and would be determined from time to time by the mint".

Since, in the absence of any machinery for redeeming rupees such as was set up under the Gold Exchange Stand-

ard, there was a risk of inflation under the proposed system, General Strachey took the precaution of suggesting that "the gold seigniorage received by the mints should be sold in India or remitted to England, and further that the mints should not coin for the Government".

As yet, however, Sir D. Barbour and the Government of India were firm in their preference for International Bimetallism; and it is interesting to find them using against General Strachey's proposals the same arguments that were employed later against their own proposals to close the mints in 1893 and to raise the exchange to 1s. 4d. in 1898.(1) Thus, it was urged that the proposed fixation of the exchange would mean the return of rupees from hoards as well as from other countries; that the closing of the mints would have a disastrous effect on the market price for silver; that the appreciation of the rupee would be an injustice to the tax-payer, and that Strachey's proposal amounted to a dangerous experiment in the manipulation of Indian currency.

Sir D. Barbour's review of the situation.

But, the inexorable logic of events, the obvious impossibility of the re-establishment of Bimetallism, the great increase in the production of silver, and the imminent danger from the repeal of the Sherman Act, convinced not only the Government of India but the commercial interests of the country that the time had arrived "for the adoption of the only remaining effectual remedy, viz., a gold standard". In his masterly Minute of 21st June 1892, Sir David Barbour laid down the principles which were to serve as the guides for the monetary policy of India for many years to come. He still insisted that "an international agreement for the free coinage of both silver and gold and for the making of them full legal tender at a fixed ratio

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(1) See Sir D. Barbour's Memorandum of 11th June, 1886.

would be far better for India and all other countries than the establishment of the single gold standard, even if the latter course be possible.'' But while thus reasserting his old convictions, he saw the impossibility of basing his policy on them, and under the stress of the changed circumstances his financial genius applied itself to the solution of the problem before him on new lines. He was fully aware that the attempt to establish gold standard in India ''is not free from risk'', for ''history affords instances of the establishment of gold standard in one or more countries but sooner or later the standard was changed''. There were also dangers from the emergence of rupees from the hoards and from their return from abroad, as the rupee became appreciated in value. On the other hand, there might appear a premium on gold coins, or gold might cease to be brought to the mints. Measures might in such cases have to be taken to contract the rupee currency, and such measures might prove expensive. But such difficulties, he argued need not deter India from attempting to achieve a gold standard. ''We already labour under difficulties which are quite as great as those to which an inconvertible standard would expose us. The prospect of being unable for a time to effectively establish the gold standard need not, therefore, deter us from the attempt to do so, if we see a prospect of success in the future''.

There are degrees and varieties of the gold standard; and the problem was which variety was to be adopted in India. Sir David Barbour argued that ''a gold standard with a purely gold currency was impossible in India'' and that ''for monetary purposes in ordinary life gold coins would hardly be used''; but he pointed out that ''the example of France and other countries showed that it is possible to have a gold standard, although a large percentage of the circulation consists of overvalued silver coins which are legal tender to any amount''. He expected that

"with a gold standard, India would require, and would use, a very large amount of silver rupees, and would neither require nor use a large number of gold coins".

With characteristic caution, Sir David Barbour refused to be guided by those who would inaugurate the gold standard by accumulating a gold reserve, declaring a ratio to be maintained between gold and the rupee, and by the assumption of the obligation of convertibility by the Government of India. The provision of the gold reserve would be an expensive affair, and if it was exhausted in redeeming rupees the cause of gold standard in India might suffer an irretrievable disaster. The same cautious attitude was to be noted in his programme for the introduction of the gold standard for India. In the minute he proposed a stoppage of the free coinage of silver followed after an interval by the opening of the mints to the free coinage of gold—the interval to be utilised in studying the effect of the closing of mints on the value of the rupee. As he put it later, "no further steps were to be taken until the effect of closing the mints had been ascertained". In such careful hands the achievement of the Gold Standard was on the one hand secure, and on the other hand, there could be no fear of premature or hasty action. Some years later, as a member of the Fowler Committee, Sir D. Barbour declared that he had realised that in the establishment of the gold standard there was a very difficult task before the country and one which might involve heavy sacrifices.[1] As it turned out, the period of probation proved even longer than he had anticipated.

The work of the Herschell Committee.

The ideas formulated in the Minute of Sir D. Barbour were embodied in proposals of Government of India and placed for consideration before a Currency Committee

(1) Fowler Committee Q. 10,159—64.

which consisted of persons of considerable ability and experience in monetary matters. Thus the President of the Committee Lord Herschell had already made a name as the President of the Commissions on the Depression of Trade and on Gold and Silver. Sir Thomas Farrer (afterwards Lord Farrer) had distinguished himself both as a member of the Gold and Silver Commission and as Secretary to the Board of Trade. Then there was General Strachey with his unique experience of India and his profound insight into the financial and monetary problems of this country.

(*a*) The case against Silver Mono-metallism.

That silver mono-metallism which had been long since abandoned by so many nations of the West, and which was so soon going to be dropped by a number of nations of the Far East, was now definitively on its trial before the Herschell Committee. That Committee decided the issue on the ground of the special hardships and burdens to Indian trade and finance from the fall in the value of silver in terms of gold. But, behind these factors, lay larger considerations which had led so many countries, as they progressed, to abandon the silver standard. Gold had become the international currency, and with the widely developing volume of international trade the fluctuations between the values of the local currency and international currency were becoming extremely burdensome. With the growing intercourse both as regards trade and capital movements between India and the West a common standard was becoming not only a great convenience but an imperative necessity. As Prof. Marshall well observed, many adjustments would go on with a gold currency in India, or even with a thoroughly well-established gold standard, which do not take place without such gold currency or standard. It was time, as the same high authority observed on another occasion, to bring the monetary "railway guage

of India in unison with the main line". The urgency for such a measure was the greater since with the demonetisation and constantly narrowing market for silver the price of silver was steadily falling, while the increase in production of silver especially as a by-product made the problem of steadiness in the value of silver a hopeless one.

These larger considerations making for a general abandonment of the silver standard were not adverted to by the Herschell Committee, which confined itself to an examination of the case of India. Consequently, its reasoning on the matter appears less convincing than it really was. To take the first issue before the Herschell Committee, as regards the financial difficulties of the Government of India owing to the fall of exchange, there can be no doubt that while the budgetary effects of any particular fall in exchange could be got over by suitable readjustments, a constantly *falling* exchange must make any financial foresight or equilibrium impossible. Now, there was no assurance at all in 1892 that there would be no further fall in exchange; rather there was every prospect that with the repeal of Sherman Act a much greater fall of exchange was imminent. It might be admitted that with the fall of exchange there would be items of compensation to be taken into account. But what with the heavy losses on exchange and uncertain and partially offsetting factors, the budget of India would be a continuous gamble in exchanges, and great uncertainty would be introduced into Indian Finance. It was very necessary to remove the continual danger of deficits from causes over which the Indian minister of finance had no control. Finally, as Prof. Kemmerer has pointed out "from 1873 to 1893 the increase in India's home charges were in the main not nominal but real, since the unit in which her fixed obligations were expressed had been increasing rapidly in size".

There was of course, the alternative of letting the rupee depreciate indefinitely on the one hand, and balanc-

ing this by increasing taxation on the other hand. In particular, Sir R. Giffen, speaking before a later Committee, argued the necessity of additional taxation as a corollary of the depreciating rupee. But, surely, it would be highly unwise and illogical to retain a standard which was bound to go on depreciating and to repair that mistake by putting on more taxes. Such a course would be politically dangerous, and would make the people think "that the Government's revenue and expenditure are increasing faster than they really are". The better opinion, certainly, was that of Prof. Marshall who argued that "though equitably the Government of India can raise its taxes so as to take its share of the growing wealth of the country, its freedom of action is practically limited by the necessity of going rather more slowly, and in a less aggressive manner in the East than is possible in the West."

The strongest argument put forward by the Committee against the continuance of the Silver standard was that the open mints would attract depreciating silver. "An open mint in India offers a market into which silver could be continuously poured without regard to the currency requirements of India and such imports of useless silver were certainly injurious to India." Further, such constant coinage of Rupees must lead ultimately to a great rise of the Indian price-level which already appeared to be inclining upwards. We might be sure that if India had been on a silver standard during the first decade of the present century, the coinage of rupees would have been far greater than it actually was, and prices would have risen much higher than they actually did. Such a rise of prices would have injured many sections of the population, though of course the burden would have been most felt by the poorer classes.

(b) Exchange and trade.

The second issue before the Herschell Committee was as regards the effect of the fall in exchange on the foreign trade of India. It was argued by many business men that the tendency of a falling exchange was to stimulate exports. The answer was obvious that such a bounty could only be an irregular and temporary one, until the inevitable adjustment of costs of production was brought about. The Committee argued further that the bounty, such as it was did not benefit India as a whole "though it may temporarily benefit the employer at the expense of the wage-earner," because wages rise more slowly than prices. This was a piece of excellent theorising on the part of the Committee, and it anticipated in its way Prof. Marshall's evidence on the subject before the Fowler Committee. The Committee also analysed the statistics of Indian exports and imports for the last twenty years, and showed that there was no perceptible correlation between the fluctuations of exchange and those of foreign trade. This was another proof of the theoretical soundness of the views of the Committee; for exchange is only one factor influencing international trade and by no means one of the most important among these factors. It might have been added that the alleged effect of the falling exchange in stimulating exports and in hindering imports was being constantly counteracted by the fall of gold prices abroad.

(c) Proposals for the closing of mints to silver.

Having decided against the continuance of the silver standard in India the Committee proceeded to examine the proposals of the Government of India which had been drawn up by Sir D. Barbour. The proposals were in fact based on his Minute, and the first objection to the scheme was whether it was practicable to maintain the rupee at an artificial value. In order to resolve this doubt the Committee made an examination of the different systems of

currency, especially those of France, the United States and of Austria Hungary. As the result of this examination it appeared that "it has been found possible to introduce a gold standard without a gold circulation; and even without legal convertibility of an existing silver currency into gold".[1] It was recognised that the precedents quoted were not directly applicable owing to differences of circumstances, nevertheless they showed "under what various conditions the exchange value of a currency may be maintained".

The proposal to close the mint was also objected to on the ground that it would cause an appreciation of the rupee and "that thereby the burden of Indian taxation would be increased". The Committee regarded this consideration as offset by the fact that the prevailing prices *which were adjusted to the present ratio* or to some ratio differing but little from it would be maintained. As the Government's proposals based the ratio "on the average prices of silver during a limited period before the introduction of the gold standard", substantial justice would be thus secured. It was also noted that the alternative to the closing of mints and the stabilisation of ratio could only be increased taxation.[2]

It was further objected that the closing of the mints would, on one hand, increase the advantage of other silver-using countries in their competition with India, and on the other, reduce the exports of India to such countries. The answer given to this by the Committee had both a theoretical and a historical side. It was alleged, on the one hand, that even in China an adjustment of costs to the silver prices must take place leading to a disappearance of the temporary advantage. This theoretical reasoning was corroborated by the exchange and trade

(1) Herschell Committee's Report, paragraphs 96—98.

(2) Herschell Committee's Report, paragraphs 110—112 and 47.

statistics of the past twenty years, showing that the advantages in trade believed to accrue from fluctuations in exchanges were of a fleeting and indecisive character.[1] A wider survey of figures since the time of the Report shows that the Committee took a correct view of the matter, as was only to be expected from a body with such eminent *personnel.*

Finally, the Committee considered the contention that under the Government proposals the Indian currency would not be "automatic, since the Government would be enabled to contract or expand the currency at will".[2] There was included in the proposals themselves one way of limiting the discretionary power of the Government, since, after a time, any one could take gold to the Mint and have it converted into gold coins of the value of 10 and 20 rupees. But the Committee felt that this provision was not by itself enough to introduce automaticity into the new currency and it proceeded to introduce in this direction suitable modifications into the Government proposals—modifications which were real improvements.

The chief modification introduced was to the effect that though the mints should be closed to the public for the coinage of silver, they should be used by the Government for the coinage of rupees if required by the public for the exchange of gold. This provision would impart a certain automaticity to the currency, in as much as it would fix the superior limit of the value of the rupee. There was another reason too for introducing this modification. The notion was prevalent at the time that as the result of the closing of the mints there would follow a sudden and considerable rise of exchange which in its turn would lead to a rapid rise of prices. In the light of events we know that

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(1) *Ib.* paragraphs 118—119.

(2) Herschell Committee's Report, paragraphs 109 and 150.

these anticipations were quite unfounded.[1] But, at the time, the modification introduced by the Committee served the purpose of allaying these apprehensions.

The Committee introduced another significant modification in Sir D. Barbour's plan. It was to the effect that at the Government treasuries gold should be received in satisfaction of public dues at the ratio fixed. This was an improvement upon the Government proposal and it was provided that "the power to admit sovereigns as legal tender might be of use as an *ad interim* measure, and need not be used except in case of necessity". The basic idea of this particular modification was that the procedure would serve as a means of familiarising the public with the use of a gold currency.[2] Here was a direct preliminary step towards the introduction of a gold standard as well as of an auxiliary gold currency.

Merits of the Herschell Committee's Report.

The Report of the Herschell Committee forms a very important land mark in the history of Indian currency; and in view both of the excellence of its treatment and the far-reaching consequences of its suggestions it deserves a far more careful study than its successor—the Fowler Committee's Report. The latter owes much to the Herschell Report, and, in the main, carries the ideas contained in the Herschell Committee's Report some steps further to their logical conclusions. Thus, the earlier report anticipated its successor as regards the possibilities of a gold standard in India, the foreign examples to be followed in this respect, the problem of convertibility and even the ratio to be adopted. At the same time, the idea of the gold standard was much more scientific as conceived in the earlier report, and it was based on a wide survey of the

(1) Herschell Committee's Report, paragraphs 146—151.

(2) Herschell Committee's Report, paragraphs 152 and 156.

different varieties and degrees of the gold standard prevailing in various countries. As one of the members of the Herschell Committee put it, the essence of the gold standard as introduced in India was that "the rupee should be equivalent to a certain proportion of the ounce of gold"; on the other hand the later Committee took a too strait-laced view of the character of the gold standard.

The Herschell Committee took a bold and comprehensive view of the problem before it. We now know that there were some members of it who considered that their terms of reference directed them to consider only the question of stopping the coinage of silver in the Indian mints, and were doubtful as regards the inclusion of the problem of the introduction of the gold standard in their task. The Committee, however, decided that the mere closing of mints would be only a partial remedy unless the larger question was also tackled.[1] Further, it went on to secure currency automaticity to the largest possible extent even during the transitional period. It selected for adoption the best features of Sir D. Barbour's plan, and recommended modifications which were also improvements. It was not the least of its merits that it took care that its recommendations should involve the smallest departure from the *status quo*.

Reference might also be made to the general soundness of the theoretical position taken up by the Committee and to the merits of its survey of monetary and trade statistics. It took its stand on the best available economic analysis as regards the effect of an appreciating currency upon exports and imports, upon wages and upon the wealth of the country as a whole. There are traces here of the influence of J. S. Mill's teaching as regards a bounty on exports from depreciating currency leading to the development of counteracting forces. Nor, perhaps, was the

(1) Evidence of the Rt. Hon. Leonard Courtney, before Fowler Committee, Q. 13,031.

evidence of Prof. Marshall before the Gold and Silver Commission of 1888 without its influence. The Committee was also on its guard against exaggerating the effects of exchange fluctuations upon trade and industry. To take another aspect of its work, it was one of the first Committees sitting in judgment on a system of managed currency. In spite of the prevalent prejudices of the day against such currency which were voiced by eminent authorities on monetary topics like Giffen and MacLeod, the Committee proved by an analysis of the existing systems how much the element of management entered into many of the contemporary currency arrangements.[1] Of particular importance, in view of the standard to be soon introduced into India, was its study of the system prevailing in Austria-Hungary, which by the legislation of 1892, possessed "a *regime* which was in fact exactly analogous with that of the gold exchange standard". As the Committee observed it was a remarkable case in which the mints were closed against a free coinage of silver. A gold standard had been adopted, a gold reserve had been accumulated, and "fair steadiness of exchange had been maintained for more than a decade". The Committee was also impressed by the example of the Dutch East Indies where there was little or no gold in circulation, and yet the country was on a gold standard, while "the rate of exchange between Java and Europe is always at or about par".[2] Here we can trace the influence of two countries, which had systems analogous to the Gold Exchange Standard, upon the course of the monetary development of India.

Finally, attention might be drawn to the remarks of the Committee on the topic of the ratio. It emphasised the tentative character of the ratio of 1s. 4d., which it had suggested. "It would not" it urged, "be essential to the

(1) Herschell Committee's Report, paragraph 91.

(2) *Ib.* paragraphs 88—89.

plan that the ratio should never be fixed above 1s. 4d. Circumstances might arise rendering it proper and even necessary, to raise the ratio."[1] These remarks are not without their value even as regards the controversies of our own day. But, further, the Committee showed its wisdom and caution in recommending that the ratio to be fixed should not be materially higher than the one prevailing at the time —in a word the stabilisation was to take place at a rate which did not greatly differ from the market rate.

In making this recommendation they were going against a great deal of prevalent opinion, and were even modifying the proposals of Sir D. Barbour himself. Nevertheless experience showed the wisdom of the course suggested by the Committee. As it was, it proved a long and difficult process to maintain the ratio at 1s. 4d. With the constantly improving position of India in trade a higher ratio could have been ultimately reached and maintained; but the difficulties would have been much greater and the effort would have occupied a much longer period.

The evolution of the idea of the "Gold Standard" in the Currency literature of India.

The definitions of a Gold Standard, and the meanings of and interpretations put on that term, have quite an interesting history which throws light on the progress of thought on monetary matters. The earlier definitions laid an undue emphasis upon there being no standard money other than gold coins—all other coinage being token or subsidiary *i.e.,* they are to be "only legal tender for strictly limited and inconsiderable sums". This very rigid definition was based upon the conditions prevailing in Great Britain (the path-breaking country as regards the gold standard) during the early period of the formation of our monetary theory. It was a relaxation of this strict

(1) *Ib.* paragraph 151.

definition when it was added that, if there was coin of any other metal in circulation as legal tender it should be convertible into gold. This enlargement of the definition was due to the experience of the United States and in the last century, and to some extent, of France. It took still longer before it was recognised that the pre-war monetary system of India, and the closely allied systems prevailing in Russia and Austria-Hungary before the War, were all varieties of the gold standard.[1] A great deal of monetary experience was required before it was recognised that the essence of the gold standard lies in "the tying of the value of the monetary unit to the value of gold by the fixing of the price of gold"—as Mr. Hawtrey has put it.[2] Similarly, Prof. Cassel conceives the gold standard as a free standard under which the price of gold is fixed within certain limits. It is now recognised that a gold currency is no necessary part of a gold standard, while the older definitions of a gold standard made a gold currency the most important feature of a gold standard. But as Dr. Cannan put it, "when you get on to the bare bones of the gold exchange system there is very little difference between the two" *i.e.*, between the gold currency system and the gold exchange standard.[3] Any difference that might exist is not in the nature of the two standards but between their simplicity or intelligibility and in the technique of management.

We have evidently traversed a great deal of ground since the days when Mill could describe a gold standard country as one where "the exclusive standard of the currency is gold". The development of theory in our times has been away from that line of opinion which was based on the view that money was essentially a commodity. In

(1) Hawtrey, *Currency and Credit* (1919), pp. 320—337; D. H. Robertson, *Money*, p. 154.

(2) Hawtrey, *The Gold Standard*, p. 31.

(3) Royal Currency Commission of 1925, Q. 13,210; 13,231; 13,330.

our days it has been recognised that "even under the gold standard, the standard—for instance the Dollar Standard—has its independent existence".[1] We now emphasise the notion of "the *unit of account* with a given purchasing power in which people compare the values of commodities exchanged." Nogaro sums up this tendency clearly when he observes that "in proportion as the notion of money develops it becomes gradually more and more detached from that of a given commodity and becomes a notion of account with a given purchasing power."[2]

The one author whose notions on this as on many other subjects seem incapable of being antiquated is Ricardo. While he has not given us a formal definition of a gold standard he gave us what was better—a scheme of what he conceived to be the best type of the gold standard; and, it is well to remember that the variety of gold standard which India adopted after 1900, as well as the proposals for Gold Bullion Standard of 1926, were both based on the Ricardian model. Those few who are still inclined to doubt whether the pre-war system of India was a true gold standard might well be asked whether they would include the Ingot plan of Ricardo in that category.

The above digression will be of help in noting the evolution of the idea of gold standard in the course of the various controversies relating to Indian currency. To start with, we come across notions or descriptions of the gold standard which correspond to the earlier definitions by theorists. Thus General Mansfield (the great advocate of a gold currency in India during the' sixties) expressed his view that as long as the rupee was not reduced to a token or subsidiary coin with a limited legal tender, India could not be said to be on a gold standard. That consideration

(1) G. Cassel, Vol. II, p. 476.

(2) Nogaro, *op. cit*, pp. 164—165.

led him to conclude that it would take a generation to introduce a gold standard into India. The idea that the gold standard necessarily implied a gold currency as well as the reduction of the rupee to a token currency prevailed for a very long time. Thus, in the controversy which was carried on during the year 1876 between Mr. R. B. Chapman (then Financial Secretary) and General Strachey, the former denounced the view that "in order to have a gold standard, gold currency is not necessary" as an "outrageous heresy".[1] As to silver currency, Mr. Chapman emphasised that with a gold standard most of the rupees would have to be recalled and sold. Further, the absolute convertibility of any silver coinage into gold was made an essential condition of a gold standard. "A true silver subsidiary currency must I maintain, be treated as a note currency, *i.e.*, it must be issued only in exchange for gold, and the State should be compelled to give gold for it, at convenient centres on demand, every where". As in the case of the earlier English theorists, their Indian followers based this rigid definition of a gold standard on the prevailing practice of England as a gold standard country. Thus, Mr. Chapman argued that "if a gold standard be permanently possible without a gold *currency*, why should Great Britain or any other country endure the needless waste of a gold currency?" It is obvious that the fact that Great Britain was then the gold standard country *par excellence* was influencing the current definitions of the gold standard. Again, before the Fowler Committee, Prof. MacLeod argued that, you cannot have a gold standard without a gold currency"; he added that a gold standard for India should be "on exactly the same lines as the British system which is now universally recognised as the most perfect system ever devised by the ingenuity of man".[2] The Fowler Committee took the

(1) The demi-official correspondence between General Strachey and Mr. Chapman (then Financial Secretary).

(2) Fowler Committee, Q. 12,945 and 12,957.

same view and had for the *ultimate* object of its recommendations "the effective establishment in India of a gold standard and currency on the lines of the British monetary system. It added that "under an effective gold standard rupees would be token coins subsidiary to the sovereign". But in the matter of the convertibility of the silver coinage into gold both the Fowler Committee and Prof. MacLeod (whose views the Committee deferred to) softened the rigour of the older definitions of the gold standard. The Committee would not bind the Government to part with its gold in exchange for rupees; while MacLeod asserted that "in no country in the world is silver convertible into gold at the will of the holder".[1]

But, while in general, the older definition of the gold standard held the field in Indian monetary controversies at least up to the time of the Fowler Committee, the more recent conception of a gold standard was being foreshadowed before that time in various quarters. Thus, as early as 1876, General Strachey was urging that a gold currency was not necessary in order to have a gold standard. Indeed, he added that under a gold standard the demand for a silver currency on the part of India will not be greatly reduced. Further, Col. Smith—the talented mint-master—had forestalled even General Strachey on this point. Col. Smith had already made proposals for a "regulated currency kept at par by placing a seigniorage on the coinage of silver", and this idea had been also adopted in the proposals of the Government of India in 1878. This was another notable departure which pointed to the development of monetary theory in our own time when far less importance is attached to the element of "automaticity" of currency, and the idea of the element of regulation as necessary under any system of currency is generally accepted. We have already referred to Col. Smith's view that

(1) Fowler Committee, Q. 12,962.

"a gold standard may exist with any kind of currency, provided that the latter can only be obtained by the delivery of gold". In all these matters we find that, under the stress of circumstances, *India was one of the first countries to depart from the more antiquated notions about the gold standard.*

The ideas of regulation of currency and of the possibility of having a gold standard without a gold currency were reiterated and emphasised in General Strachey's Memorandum of the 31st March 1886 as also in Sir D. Barbour's famous minute of 21st June 1892. In the former, it was proposed to dispense with a gold currency, and to introduce a gold standard under which "a fixed number of rupees in silver would be given by the Mint in exchange for a fixed weight of gold. The gold would not be coined, and would merely serve as a medium by which to measure the future cost of the rupee". Provision was thus made for the automatic expansion of currency according to the demand for it.

In the clarification of ideas regarding the true nature and variety and degrees of the gold standard the Report of the Herschell Committee occupies an important place. What are now the maxims of text books were to be ascertained forty years ago only by a wide survey of the different systems of currencies. The Herschell Committee undertook such a survey and found out for itself the great variety of conditions and systems under which the gold standard had been maintained. They concluded that "however admirable may be the precautions of our own (British) currency system, other nations have adopted different systems which appear to have worked without difficulty, and have enabled them to maintain for their respective currencies a gold standard and a substantial parity of exchange with

the gold-using countries of the world."[1] Here was a comprehensive study which fully brought out the capacity of the gold standard for adaptation to the needs of different countries as also the fact that it admitted of a number of variants and degrees. Thus, as that Report says, a gold standard was found to be possible with little or no gold coin, without any mint or gold coinage, with only inconvertible paper in circulation, and with a circulation consisting of token silver only. It was the merit of Lindsay to see the potentialities of this last variety of the gold standard and to adapt its mechanism to the requirements of India as well as to ground it on the teaching of Ricardo. In fact, he emphasised the importance of fixing the price of gold in the money of a country as the essence of the gold standard. Gold is the international currency and as Lind say said "a currency that is not interchangeable with the currencies of the great commercial and financial countries is inelastic; it cannot expand and contract freely".[2] He emphasised the fact that under his scheme fresh currency could only be issued against deposits of gold. The scheme of Mr. Probyn was also based on correct and modern notions of the gold standard, and could it have been adopted, would have anticipated the Gold Standard Act of 1925 by many years. We thus see that under the pressure of circumstances correct notions about the Gold Standard were formed and adopted in India at an earlier date than in any other country.

(1) Herschell Committee's Report, paragraph 93.

(2) Fowler Committee, Q. 3,305.

LECTURE III.

THE STABILISATION OF THE EXCHANGE RATIO AND THE EXPERIMENT IN GOLD CURRENCY, 1893-1900.

The task before the Fowler Committee.

The Herschell Committee had given a new orientation to the monetary policy of India. The aim of attaining some variety of gold standard had been avowed and was at the base of many of its suggestions. But its main work had been of a negative character—that of trying to make the rate of exchange independent of the price of silver by the closing of mints to unlimited coinage of rupees. A preparatory stage of transitional arrangement had followed; and now the task remained of framing the permanent arrangements for fixing the ratio in the light of experience, for envisaging the type of gold standard to be adopted and for framing the programme for its adoption. The Fowler Committee had before it the task of judging between the various schemes which had been proposed for securing a gold standard for India. Some of the schemes, though now familiar enough, appeared very strange indeed in those days. Thus the Lindsay scheme itself was described at the time as one which "would have the Government start as a stock jobber and offer to buy and sell rupees in the region of 1s. 4d. at a difference in favour of the jobber of about two per cent".[1] Then again the merits of the proposals for the contraction of currency had to be judged. The closing of the mints had brought in its wake an appreciation of the rupee; but it had also been accompanied by monetary stringency which had hit the mercantile community. The issues here were, whether there had been

(1) Mr. F. C. Harrison in the *Economic Journal*, June 1898, p. 221.

either a relative or absolute contraction of currency; whether the high discount rates prevailing were due to such contraction; and, finally, whether the policy, if it had been successful should be carried to a logical conclusion by melting some crores of rupees in circulation. The business community in India was in no mood to tolerate further uncertainty of currency policy. It was this uncertainty which was standing in the way of the further appreciation of the rupee and of the import of further capital. Stability, both of the exchange and the currency policy, was the cry. To secure this object, ample powers were given to the Fowler Committee—they were to frame recommendation for the establishment of a satisfactory system of currency for India and for securing as far as possible a stable exchange between India and the United Kingdom.

Monetary developments (1893-1898).

The course of events during the period 1893 to 1898 and the prevailing tendencies of the day might be briefly adverted to here. The merits of the Report of the Herschell Committee and the decisive character of its recommendation regarding the abolition of the Silver Standard were generally recognised. Experience soon showed that those who had prophesied a decline of the export trade, unfavourable balances of trade, and a fall of Government revenues, as the results of the closing of mints, were quite in the wrong.[1] Rupee securities, too, had improved on the London stock exchange. Nevertheless, in India confidence in the new policy was a plant of slow growth. For one thing, it was known that there had been notable differences among the members of the Herschell Committee on important matters. On the vital matter of the formation of a gold reserve of which the object should be to keep up the parity of the rupee, the Committee had

(1) Cf. the Evidence of Sir J. L. Mackay before the Fowler Committee.

been divided;[1] and the merit of insisting on the accumulation of a sufficient reserve of gold is due only to two members of the Committee Lord Farrer and Sir Reginald Welby. In the absence of such a reserve, the claims regarding the early advent of the gold standard appeared very shadowy. Again, though the Herschell Committee deserves to be commended on its caution in not fixing once and for all the new gold-value to be assigned to the rupee, and in insisting upon a period of transition, yet one can sympathise with the complaints of the business community about the fluctuations of exchange and with their want of absolute confidence in the policy pursued. Nor, so far as could be seen at the time, had the direct object of the closing of the mints—the contraction of the rupee currency—been attained. It was believed that rupees were emerging from hoards and coming back from abroad.

Again, while Sir D. Barbour and other administrators had manifested no undue confidence about the immediate establishment of the 1s. 4d. ratio, the business community had taken the opposite view for a time. Such confidence, though unfounded, proved infectious and a premature attempt had been made to manipulate the exchange by stopping the sale of council bills during the latter part of 1893. This procedure was disapproved of by experts like Sir D. Barbour and Mr. Lindsay, and while encouraging an import of the cheapened silver it disturbed the export trade of India. The exchange rose indeed, but slowly and only towards the end of the period. Prof. Kemmerer has well summarised the tendency of exchange during these years by observing that "although during this period the exchange value of the rupee was always far above the bullion value, and the difference tended to be widening one, there was still a remarkable parallelism in the movements of the two curves of the foreign exchange and the bullion value of the rupee."

(1) Probyn, *Indian Coinage and Currency*, p. 65.

To the student of economic history the slow success of the policy of 1893 will be no matter for surprise. For the year 1893 in which the Indian mints were closed happened also to be the year in which a new trade depression began which lasted until about 1896. As W. Mitchell has pointed out the business expansion of the later eighties had been terminated by the financial crisis of 1890. The year 1891 witnessed financial prostration in England while the whole periods 1891-94 brought trade depression and bad harvests throughout Europe. America was the seat of a monetary panic in 1893; and, generally speaking, the brief revival of 1895 had been succeeded by a return of the depression. Under such adverse conditions the success of any currency reform is naturally delayed.[1] It is an interesting coincidence that about the same year that the mints were closed to silver in India, monetary reforms were also initiated in Austria and Russia on lines similar to the Gold Exchange Standard system. What is more, as in the case of India, these reforms achieved success only when the trade depression disappeared and gold prices abroad began to rise.[2]

After the year 1896, a fresh disturbing factor made its appearance in India in the shape of great monetary stringency and a considerable rise of the rates of discount during the busy seasons. It is interesting in this connection to note that in the same year 1896, many leading countries of the West felt a monetary stringency. There was much controversy as to the causes of the stringency in the Indian money market. On one side it was asserted that the stringency was due to the relative contraction of the currency and to the closure of the mints. Others attributed the stringency to the deficiency of loanable capital which was due, in its turn, to the want of confidence in the exchange.[3] Looking back on the course of events, would appear that the end of the trade depression by the year 1896 was improving

(1) W. C. Mitchell, *Business Cycles*, pp. 49 and 56—59.

(2) Hawtrey, *Currency and Credit* (1919), pp. 325—328.

(3) Lindsay, Q. 4,097—4,099. (Fowler Committee).

the conditions of trade and industry and making larger demands on the capital and currency of India.

The case against Silver mono-metallism.

The first problem considered by the Committee was how to put an end to the then existing abnormal and uncertain state of the currency—whether by reverting to the silver standard which prevailed before 1893, or by introducing some sort of gold standard. Lord Farrer described before the Committee the state of things prevailing between 1893 and 1898, by observing that India had been without a complete standard. "It is a state of things in which you have —I do not know how to express it—an anomalous standard, a rupee with a superior limit, and without an inferior limit, as measured in gold".[1] The Committee noted that under the prevalent conditions there was "no legal relation between the rupee and gold". Only the Government of India had for the time being declared a rate at which rupees could be obtained for gold, and as a result of this declaration the upper limit to which the rupee could rise was determined for the time being.'

The case for the restoration of the silver mono-metallism found an able champion in Sir R. Giffen.[3] He argued that owing to the poverty of India and to the fact that it had to resort to borrowing even to meet its obligations, an effective gold standard was out of the question. The proposal to alter the standard was, he observed, brought forward by the Indian Government mainly on account of its own financial difficulties, and by individual business men also as a solution of their own special difficulties. So far as the financial difficulties of the Government were due to a rise of prices, he proposed that they could be legitimately met by increasing taxation.[4] A restoration

(1) Fowler Committee Q. 12,171—12,172.

(2) Fowler Committee's Report, paragraph 16.

(3) Fowler Committee Q. 10,109—10,113; 10,238—10,248.

(4) Q. 10,050—10,059.

of the old silver standard would no doubt bring with it exchange fluctuations, but then such exchange fluctuations were not so a great disadvantage to trade as had been suggested. Such was the theoretical case for the re-opening of the mints as presented by Sir R. Giffen.[1] From it we turn to the "idols of the market place", and find less substantial and more fallacious arguments employed by representatives of particular industries and trades. The well-worn contention was advanced that "a low rupee and a low exchange" encouraged the export trade of India. We have already dealt with this line of reasoning before. It was further argued "the present system of closed mints handicaps India in her industrial competition with countries on a silver standard." For instance it was alleged that the rise in the exchange value of the rupee increased the cost of production of tea in India, while other tea producing countries which were on a silver basis were favoured in competition with India by the divergence between the value of silver and the exchange value of the rupee.[2]

The Committee had little difficulty in dealing with the arguments advanced by the business men. It contained eminent business men who envisaged the matter clearly, and met the arguments urged before them conclusively. The stimulus given to Chinese producers by "the greater fall in the London exchange with China as compared with the fall of exchange with India" was bound to be a transitory affair "and could only continue until circumstances have brought about the inevitable adjustment". The Committee was satisfied that there had been such an adjustment and that prices and wages had risen in China.[3]

In deciding against a reversion to the silver monometallism the Fowler Committee builded better than they

(1) Giffen's Evidence, Q. 10,238—10,248; 10,367—70.

(2) Evidence of Messrs. Christie and Leake and of Mr. G. L. Acworth.

(3) Fowler Committee's Report, paragraph 24.

knew. The true reason for changing the standard consisted, not merely in any temporary relief given to public finances, or convenience to trade. The main considerations were the great increase in the production of the metal especially after the year 1885, the fall in the monetary demand for it due to demonetisation of silver by various advanced countries, and the consequent phenomenal fall in its value. As Laughlin put it "the really revolutionary action in the downward movement of silver has come since 1890. From a ratio of about 1: 40 we have to discuss a change to the level of 1: 34. In the short period between September 1890 and March 1894, the price of silver fell to one-half its value on the former date....No such change has ever before been recorded in the history of gold and silver. Neither the famous output of silver from the South American mines in the sixteenth century, nor the greater production of silver in Mexico about 1761-1820, had any thing like this effect".[1] The world's production of silver rose from about 90 millions of ounces in 1885 to over 170 millions in 1895 and to over 230 million ounces in 1911-12. With demonetisation of silver in the leading countries, we might be sure, that a great portion of this cheapened and ever increasing mass of white metal would have been dumped on India. There would have resulted a steady depreciation of the rupee and a continuous rise of prices in India, causing great social injustice, injury to trade and dislocation of public finances.

End of the Bimetallic controversy.

About the same time that silver mono-metallism was definitely turned down, another long controversy was terminated so far at least as India was concerned. The success of the Republican party in the United States led to the appointment of the Wolcott Commission by President Mc Kinley, to carry on negotiations for securing a basis for

(1) History of Bimetallism, p. 176.

another Bimetallic Conference.[1] The world was not yet fully aware that the ground had been cut away from under the Bimetallic propaganda by the disappearance of the great depression of trade and industry, as well as by the development of gold production. The proposals, therefore, met with unexpectedly favourable reception. Even the Government of England which had so far discouraged Bimetallic proposals showed itself well inclined to the new suggestion, and went so far as to agree to the keeping of one-fifth of the bullion in the Issue Department of the Bank of England in silver. But a line was drawn at the French proposal that England should purchase 10 millions of silver per annum, which would have introduced a sort of Sherman Act into England. Even the stalwarts of Bimetallism, like Lord Aldenham, regarded that proposal as "a very foolish and futile thing". The French insistence on the ratio of 15½ to 1 was also a very great obstacle. As the bimetallists admitted, "the refusal of the proposals in their then form was inevitable," but they wished that the negotiations had been continued and that efforts had been made to effect a compromise as regards the ratio "bringing it to some where in the neighbourhood of 2 to 1".

Some surprise was expressed at the unfavourable attitude of the Government of India to the proposals. But there were good reasons for India declining to co-operate with the bimetallists, and for treating the question as closed so far as our country was concerned. One of the main difficulties was the proposed return to the old ratio of 15½ to one. As Sir D. Barbour had noted, any attempt to return to that ratio would involve the most serious disturbance of the foreign trade of India, and would lead to a general and disastrous fall of prices as well as to a most drastic reduc-

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(1) Henry B. Russell, *International Monetary Conferences* pp. 438, 459—461. See also the evidence of Lord Aldenham before the Fowler Committee.

tion of currency. It was further pointed out that the proposal, if carried out, amounted to adding nearly fifty per cent to the gold value of silver, and the effects of a rise of this magnitude both upon the demand and upon the production of silver would be very serious indeed.[1] Then again, India had by this time achieved stability of exchange in a fair measure by her own exertions, and hence she had no great interest in the proposals. Finally, a condition of war on our frontiers and famine within the country was hardly propitious to new experiments in currency. These points were emphasised in the despatch of the Government of India, dated the 16th September 1897.[2]

"Relative" or "absolute" contraction.

There was a great deal of discussion before the Committee as to whether there had been either an absolute or a relative contraction of currency during the period 1893-98. The solution of the problem was of importance from more than one point of view. Those who advocated the reopening of the mints were interested in showing that the policy of closing them had led to an absolute contraction of currency, and consequently to monetary stringency, which was a "burthen imposed on the export trade of India". On the other hand, there was the proposal that since, after 1894-95 exchange had been raised by the supposed contraction, it was advisable to contract the currency further and thus to terminate the period of transition.

As regards any absolute contraction of currency since 1893, the presumption is quite against it. For one thing, there was even an increase of the rupee circulation soon after the closing of the mints, since the Government had accepted from the banks silver which had been shipped after the closing of the mints, and coined two crores of rupees out of it. As has been pointed out, we have further to take into account rupees released from Government

(1) Barbour, *Standard of Value*, p. 188.

(2) Q. 12, 839.

Treasuries by the resumption of the sale of Council bills in 1894-95. Nor can we neglect additions which were made to the currency by the return of a considerable number of rupees from the Native States as well as from foreign countries and the rupees which must have emerged from hoards.

It is true that Mr. F. C. Harrison asserted before the Committee that it was probable that the rupee circulation had decreased from 128 crores to 120 crores between the years 1893 and 1898; and his statistics have been roughly corroborated by the estimates of Mr. Adie and others. But Mr. Harrison admitted that his figures did not take full account of the return of rupees from hoards or from foreign countries. We must also take into account some important economies in the employment of the currency, like the spread of the use of cheques, as also the increase in velocity of circulation caused by improvement in communications.

The case is different as regards the possibility of there having been a relative contraction of currency. It is quite clear to us, in the light of later events, that "the monetary demand did increase more rapidly than the supply;" and it is interesting to trace the factors leading up to this relative increase of demand. The first signs of any deficiency of currency and of monetary stringency were observed by the banking authorities of India in the latter part of the year 1896 and in the beginning of 1897. That stringency was attributed partly to the curtailment of Councils caused by the famine. But there were other causes of stringency of a more promising character. As Lindsay has observed, in 1895-96 there was an extension of joint-stock enterprise in the shape of the development of jute mills and indigo mills, and an increase of commercial enterprise generally. There was also an increased demand for money, as the same authority on Indian banking matters observed, owing to the large export demand for wheat and seeds

and to the financing of high priced food crops.[1] It is this explanation of the relative contraction of currency that deserves to be emphasised. For the growth of the commercial and industrial demands for currency, which caused the monetary stringency, indicated the beginning of a movement which was destined to have a highly favourable effect upon the Indian exchange. The fact was that the world depression of 1893 was passing away and giving place to a development of trade and industry; and corresponding to this we had the beginnings of a revival of trade and industry in India leading to an increase of demand for currency. It was this revival which was causing both a rise of Indian exchange and the "relative contraction of currency" in India. That great and general prosperity of trade and industry, and the resulting demand for Indian products, were in the near future going to maintain the ratio fixed at 1s. 4d. by the Fowler Committee, and to give India a long series of favourable balances of trade in spite of the heavy coinage of Rupees. Looked at as a purely monetary phenomenon, and without reference to the trade position, the condition of things was rather surprising and puzzling. As Nogaro put it, we thus observe the curious fact that "the stabilisation of the rupee was carried out at the very time when the Government was abandoning its policy of monetary contraction, and having resigned itself to a resumption of the coinage was issuing annually between 100 and 200 millions of rupees".[2]

The Fowler Committee could not help noticing that already "in the year 1898-99 the total volume of the export trade exceeded that of all past years". But it was too near the beginning of the great trade revival to observe its full significance as regards the maintenance of exchange, and its effect on the demand for currency in India. The Committee was concerned with the question of "the relative

(1) Lindsay's evidence, before the Fowler Committee. Q. 3,462—3,464 and 3,297.

(2) Nogaro, *op. cit.* p. 36.

contraction of currency mainly on account of its bearing on the Indian Government's proposal to further contract the currency. We can now see clearly that the change of trade conditions which had already began had made these proposals inapplicable. The sequence of events was naturally not so clear to the Committee in 1898; still it is a proof of the clarity of its economic vision, that it gave the credit of the rise of exchange to borrowings on account of India in London, to the increase in exports from India, and to the general rise of gold prices. It added that "it is quite impossible to estimate the relative importance of these factors among themselves or the amount of their influence on exchange as compared with the effect of a contraction of currency". The economic student of to-day has naturally the advantage of a better perspective, and can see that the rise of world prices and the revival of trade abroad were exerting their influence both on the exchange and on currency conditions of India. In its turn, the *relative* contraction of Indian currency was no doubt helping on the improvement in the situation.

Currency proposals submitted to the Committee.

To the student of the evolution of monetary theory and practice the evidence given before the Fowler Committee is of more importance than many text-books. The names of witnesses like Prof. Marshall and Sir R. Giffen, of Lord Farrer and Mr. Lindsay would alone suffice to shed a lustre on any Committee, But, apart from the eminence of individual witnesses, every known shade of monetary opinion will be found to be fully represented in the evidence. There were stalwart champions of Silver monometallism like Giffen, of Bimetallism like Lord Aldenham, and of gold currency like Prof. McLeod. But, it was obvious that the Gold exchange standard was in the air; and it was an unmistakable sign of the near and rapid development of the Gold Exchange Standard—not only in India but in other countries—that no less than four schemes for introducing it

were simultaneously put forward before the Commission. They were those of Lindsay, Probyn, Raphael and Darwin respectively. When we remember further that some other proposals of the day, though aiming professedly at the Limping standard, had to borrow the characteristic mechanism of the Gold Exchange Standard in order to keep the rupee at parity with gold, we shall appreciate the force of the general movement towards a Gold Exchange Standard.

The causes of the spread of the Gold Exchange Standard, otherwise called the gold-reserve method, about the end of the 19th century, not only in India but in other countries of America and Europe, deserve some notice. The phenomenon is an instructive example of the adaptation of monetary systems to economic environments. With the abrupt change in production and relative values of silver and gold, the silver standard countries found themselves in difficulties connected with the exchange problem. For some time, they were attracted by the prospects held out by Bimetallism. But as these prospects faded away, another remedy had to be found for the widely dislocated exchanges. This was found in a restriction or control of silver coinage, supplemented by making the local currency convertible into gold or foreign exchange for the purpose of foreign payments. Fixity of the value of the local currency was thus secured. India led the way and was followed by Mexico, the Philippines and the Straits.[1] Even Japan which had a gold currency went over latterly to a variant of the Gold Exchange Standard.[2] The same method of stabilization was followed by countries like Austria, Argentina and Brazil. Nogaro sums up the movement thus: "by a series of changes in method the traditional gold standard regime evolved into the move modern systems which secure for national fiduciary currencies stable exchanges based on gold".[3]

(1) Arnaune, *op. cit.* pp. 394—399.

(2) Cf. Economic Journal, March, 1925, p. 66.

(3) Nogaro, *op. cit.* pp. 39, 41, 44—46.

On the theoretical side, the origins of this movement can be traced back to Ricardo's Gold Ingot plan. Both Lindsay and Probyn, who came forward with somewhat similar schemes of Gold Exchange Standard, fully acknowledged their obligations to Ricardo. On the practical side however, something was due to the system maintained successfully by the Dutch East Indies—a country which has a right to be called "the nursery of the Gold Exchange Standard". The system had been attracting notice for some time and the Herschell Committee thus described it: "This is a case in which the standard is gold, with little or no gold in circulation. The silver is kept at an artificial ratio much higher than its market value, although neither it nor the paper is convertible into gold except for purposes of export".

The Lindsay scheme.

The main and characteristic features of the Lindsay plan might be first described. He proposed to raise 10 millions sterling in London to form the Gold Standard Reserve. This figure of ten millions he based on the contractibility of the Indian Currency of which the best index was formed by the balances of the Presidency Banks, since they contained all the funds likely to be tendered for conversion into sterling money. This fund, he urged should be kept separate from Government money.[1] In case this fund was exhausted, it could be replenished by the sale of rupees in the Gold Standard Office or by further borrowing; but normally the profits from the coinage of the token rupee would suffice to keep up its size. When the balance of trade was unfavourable, drafts were to be sold on London at 1s. 3¾d. per rupee—that being the gold export point. In the sale of these reverse drafts two rules were to be carefully observed. In the first place, the local currency was to be contracted by locking up the rupees tendered. Such a

(1) Lindsay's evidence, Q. 3,390.

withdrawal of rupees would tend to depress rupee prices and to maintain the exchange. In the second place, it was not gold that was to be given to be export, but sterling drafts on the gold fund in London. When the balance of trade was favourable, Council Bills would have to be sold at 1s. 4 1|16d. But here again Lindsay would insist on not cashing the drafts out of any Government balances, for he objected to mixing up currency balances and currency reserves. Thus, under his scheme, fresh currency could be issued only against deposits of gold, and this was a precaution needed against any over-issue of currency.[1]

We might next consider the advantages which Lindsay claimed for his scheme. The first advantage to be obtained would be automaticity and elasticity.[2] Under the scheme the local media of circulation "are made to act precisely as if they were bits of gold by being made convertible into gold for foreign payment purposes"[3] In a word, the circulation would be expanded and contracted just as if the country had gold currency. You simply go on the orthodox beaten track. All "arbitrary measures for contracting the currency are to be avoided"; and we only "touch the rupees that are actually depressing exchange at the time" of contraction.[4]

The second advantage of the scheme was its economy. It was "a gold standard without gold currency—a gold standard with the most economical use of gold and the largest possible use of silver". Anticipating an idea developed by Mr. Hawtrey and other authorities of our own day, Lindsay contended that under the Gold Exchange Standard there would take place the least possible movement of gold between countries; indeed, under favourable circumstances, no gold bullion need ever be moved between

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(1) Q. 3,937—3,938. (2) Q. 4,301.

(3) Q. 3,380. (4) Q. 3,787. Q. 3,442.

London and India in the course of a year.[1] The cost of his scheme, added Mr. Lindsay, was only the interest on the initial loan raised for starting the Gold Standard Reserve. "Under my scheme all expansions of the currency yield handsome profit. It is contraction only that entails expense, and that contraction is limited".

The reply of Mr. Lindsay to some objections urged against his scheme may very instructive reading, and in this connection students of currency history will attach a special interest to his examination by Sir D. Barbour. Both Sir J. Westland and Sir D. Barbour contended that that it was possible that such large quanties of rupees implied "an undertaking of an indefinite liability" and that it was likely that such large quantities of rupee might be offered for conversion into gold, that there might be a gradual sapping away of the Gold Reserve Fund. In reply, Lindsay pointed out that the liability could not be indefinite, since it was limited by the potential contractibility of the rupee currency; "that India was still an undeveloped country and the more she is developed the more currency she requires"; and that the expansion of the rupee currency must strengthen the Gold Standard Reserve Fund continuously. It was also objected to the scheme by Sir J. Westland that the feature of Government control was wanting in it. To that Lindsay replied that it was a great merit of his scheme that it could be worked "without the intervention of the Government in any shape or form". As the scheme was automatic and as its working was purely mechanical, it could be worked as well by a bank as by a Government office.[2] Sir D. Barbour went on to suggest that while the scheme was economical and even profitable to the state, it meant that the individual hoarder would be a loser in as much as he would have to hoard in future coin of which the value as money was higher than the intrinsic value. Lindsay's comment on

(1) Q. 3,678—3,679; 4,064. (2) Q. 3,585.

that view was, such a situation would "tend to make him discard hoarding in time".[1]

Not many of the critics of the Lindsay scheme put forward their true objection to it which was at the back of their mind. To them the schme appeared an artificial and managed one, and yet too simple for the work. It appeared "rather a slender mechanism for establishing a gold standard for a country like India which is at the opposite end of the earth from England".[2] To that objection a crushing reply was given by Major Darwin who propounded a scheme which was but a modified form of the Lindsay scheme. "The great objection that has been taken to Mr. Lindsay's proposal is that they appear artificial. I do not think that the criticism is well founded. If gold is handed in to the Bank in London, and notes are handed out at another counter, nobody calls that an artificial transaction, and I think nobody calls it Government interference even if it is done at a State bank. I do not see how it makes the system any more artificial if you separate the two counters, the one at which gold is handed in, and the other at which the note is handed out. I do not see that it makes the system any more artificial, even if you place the counter at which the notes are handed out as far away as India".[3]

In a masterly study, Prof. Kemmerer has shown how the main features of the Lindsay scheme were ultimately adopted in India under the pressure of facts and circumstances. Nevertheless, there can be little doubt, that the system would have had a much better start, could it have been inaugurated as a whole on the lines suggested by Lindsay instead of being adopted price-meal. There were also some valuable features of the Lindsay scheme which

(1) Q. 3,585.

(2) Q. 3,576.

(3) Q. 12,568.

were never incorporated in the Gold Exchange Standard in India—the war having interrupted its evolution. For one thing, it would have been much better to have started operations with an adequate Gold Standard Reserve obtained in the first instance by borrowing, than to have waited until the process of coinage gradually increased it to a size proportionate to its functions. The want of an adequate and ample reserve at its inception sensibly made the administration of the system in the earlier stages less efficient than it might otherwise have been, and led to that hesitation in supporting the exchange which was noticed in the crisis of 1907. It was only after the Report of the Chamberlain Commission, that the Government gave a pledge to support the exchange to the full extent of their resources. The criticism that "there was no automatic provision for contracting the currency", and that "the Government was under no statutory obligation to support the exchange" could never have been advanced, had Lindsay's scheme been adopted in its entirety from the start. To take another feature of Lindsay's scheme—he insisted on keeping the Gold Standard Reserve quite apart from Government balances. The value of this recommendation will be appreciated by those who remember the proposals that were made later to use the profits of the coinage of rupees for public works, or in aid of general balances, as also the controversies about the rates at which Council bills should be drawn against paper currency reserve and the Gold Standard Reserve. The student of the subject might further refer to the criticism directed against individual features of the pre-war monetary system of India, to be found in the writings of such a sympathetic critic and historian as Prof. Kemmerer, and he will see how little of it would be relevant if advanced against the Lindsay scheme. The difficulty of adopting the new system *en bloc* must of course be admitted, especially in view of the imperfect contemporary development of monetary theory and practice, and the state of opinion in India at the time. Yet an econo-

mist might well pay his tribute of admiration to Lindsay, who had succeeded in outlining a system, which if it could have been adopted, would have made almost all later criticism beside the mark.

The proposals of Mr. Darwin and Mr. Raphael were avowedly based on those of Lindsay, and might be only briefly examined. Mr. Raphael agreed that his scheme was very much like that of Lindsay and that all schemes of gold standard without gold currency must be so.[1] His only apprehension about the Lindsay scheme was that it would involve an undue contraction of currency, and he would provide against it, since he believed that the Rupee currency was not redundant then, and would soon have to be increased. His proposal also differed from that of Lindsay in another detail—he would hold part of the Gold Standard Reserve in gold, in order that India could draw on it at need without causing a stringency in London.

The Probyn Scheme.

The schemes proposed by Major Darwin and Mr. Probyn are best studied together; for while they were in many respects analogous to the Lindsay scheme, they show very interesting resemblances to the future Gold Bullion Standard. Thus, Major Darwin, in his proposals anticipated a great many of the proposals of the Royal Commission of 1925-26. He would demonetise the sovereign in India at once, and he aimed at the ultimate dethronement of the rupee by providing that the liability to convert notes into silver rupees should be cancelled at some future date. The currency in India was to consist of rupees supplemented by convertible gold notes. The local currency was to be maintained at par by the Government selling gold at 1s. 4d. for notes. He preferred the convertibility to be in London, but was willing to give up that point as a minor one, and to give the gold in India. These ideas formed remarkable anticipations of the recommendations of the

(1) Q. 6,456.

Commission of 1925-26 about the demonetisation of the sovereign, the ultimate dethronement of the rupee, and making the notes convertible into gold.

The scheme of Mr. L. C. Probyn also anticipated the leading characteristics of the future Gold Bullion Standard by proposing that ultimately rupees and paper currency should be sustained at par with gold through the right to demand such local currency for gold bullion, and gold bullion for that currency.[1] In the initial stages of the scheme however, the people would only have the right to demand notes and silver for gold bullion''. As gold was handed into the reserves, the public would receive notes of 10,000 rupees payable at the option of the holder either in silver rupees or gold bars. The smaller notes would remain exchangeable into silver rupees only. As time went on, the gold reserve would be enlarged, as gold kept coming in both against the issue of the large gold notes and the smaller notes as well. In this way the silver in the reserve would be replaced by gold automatically, and a great gold reserve would be formed which would not only be useful for the redemption of the note issue, but would also keep the rupee or notes printed on silver at parity with gold. The second stage would be entered upon when gradually, the Currency Department had thus acquired a stock of gold sufficiently large to serve as the basis for convertibility. Then, with the advent of convertibility, the gold standard which was aimed at would be established, and the public would be given the right to demand gold bullion for notes and ruupees. At this stage, also, therefore, provision would have been made for the contraction of currency. Further, after convertibility is declared, all gold reserves were to be merged into one—the gold note reserve, the ordinary reserve of the currency department, and the profits from silver coinage. This last item he proposed to call the ''equivalence fund''. Gold would not be legal tender at

(1) Probyn. Q.6,854—6,862. See also Probyn, *Indian Coinage and Currency*, pp. 43—50.

any time under this scheme, but gold bars should be the basis of the Indian standard of value.[1]

Here, again, we have to note other interesting resemblances with the future Gold Bullion Standard. Thus the demonetisation of the Sovereign, the convertibility of rupees and notes into bars of gold and the amalgamation of the reserves are features common to Probyn's scheme and to the proposals of 1926. A very significant difference might, however, be pointed out. In the absence of any large resources to serve as the basis of the convertibility of rupees and notes into gold, Probyn had to provide a transitional stage during which gold was to be accumulated in the reserves gradually, through the deposit of gold and the issue of gold notes, and was not to be used for the redemption of local currency. We can infer from this, how greatly the task of the Commission of 1925-26 was facilitated by the existence of the Gold Standard Reserve which had been built up during and through the working of the Gold Exchange Standard.

And it is to be noted, further, that the main criticism that was directed against the proposals of Probyn was aimed at the arrangements suggested for this transitional stage. It was pointed out, and he did not deny it, that during this transitional stage, there would be no machinery for the contraction of the currency. *In the course of time* he added "I hope that so much gold might be held by the currency department as would constitute a reserve which might enable the Government to undertake always to issue gold bars in exchange for rupees or rupee notes". Another defect of the system during the transition period was also admitted—that two kinds of currency notes would be circulating at once—one of which would be a rupee note and the other a gold note. Such defects however were inevitable in the absence of adequate gold resources at the start.

(1) Probyn, *Indian Coinage and Currency*, pp. 33 and 49.

Coming next to examine the proposals which the Government of India put forward in March 1898, we can trace in them many of the features of the future Gold Exchange Standard. The term was not of course used, as it was not still coined. But they wanted to introduce a Limping Standard, combined with a "practical convertibility" though the legal obligation for convertibility was not to be undertaken.(1) Such a combination of a limping standard combined with partial redemption virtually amounts to a Gold Exchange Standard.[2] Further, it was proposed to form a gold reserve partly by borrowing and partly out of the proceeds of the rupees to be melted in order to secure the necessary contraction.[3] Mr. Lindsay himself noted the resemblance between his own scheme and that of the Government of India, the only point of divergence being that the latter contemplated the introduction of gold currency at some future date and making gold legal tender.[4] At the same time, the Government of India did not conceal its view that any Limping Standard established in India would have to be of an attenuated and diluted character. It was aware that gold was not likely to circulate in India to anything like the extent to which it was to be found in circulation in France. The Secretary to the Government in the Finance Department himself observed to the Fowler Committee that "France has a much larger stock of that gold than India is even likely to require and that gold would not go into circulation in India to any appreciable extent, whereas it does does in France. I understand that it is in general circulation in France nearly to as great an extent as the five franc pieces."[5] Another witness —a practical banker—also argued against the introduction into India of a Limping Standard on the lines of France. "France" he pointed out, "had a vast amount of gold cur-

(1) Fowler Committee, Q. 3,096—3,100.

(2) Fisher, *Purchasing Power of Money*, p. 131.

(3) Q. 2,646.

(4) Q. 4,073—4,074.

(5) Q. 2,945—2,946.

rency, it was also a great creditor country holding immense amounts of foreign securities. In such a country the Limping Standard could maintain itself and silver coins could not drive out the gold currency. "If India was in the position of France" said the witness to the Committee "there would be no necessity, I am sure, for you, gentlemen to be considering the currency question". [1]

The Ratio Problem.

The problem which faced the Fowler Committee, in the matter of the ratio, bore a remarkable resemblance to the one that was to be examined by the Royal Currency Commission of 1925-26. In both cases, the exchange was rising again after a period of abnormal fluctuations; and in both instances too the rise was due in some measure to absolute or relative contraction, but, in the main, to an improvement in trade conditions. In either case, stabilisation was effected at the prevailing rate of the day, after considering whether prices in India had adjusted themselves to it. An examination of the possible effects of raising the exchange on industries in general, and on agriculture in particular, had also to be undertaken in both cases. And in the arguments and the considerations which led to the raising of the exchange rate in 1898 and in 1926, there is a striking parallelism. There was hardly an argument used in our recent controversy about the ratio which had not been employed in 1898. That constitutes an additional reason for studying the Fowler Committee's Report and the evidence before it with more than ordinary care. Indeed, as the Report deals with the various issues rather briefly, its dicta have to be supplemented by those of witnesses in order to comprehend the full strength of the case.

Beginning with the main issue—that of the adjustment of Indian prices—we find the Committee observing that "prices in India may be assumed to have adjusted themselves to it (the ratio), and the adoption of a materially

(1) Q. 6,447—6,451.

lower rate at the present time would cause a distinct, and in our opinion, a mischievous disturbance of trade and business. The *onus probandi* rests on those who would now propose a different rate".[1] Those who had argued against the stabilisation at the 1s. 4d. ratio urged that it had prevailed for only ten months and further that these ten months could not be regarded as a normal period. It was contended further, that the *status quo* had not been arrived at in a natural way but by means of contraction of currency, and finally that there had been no adjustment of wages to the ratio. Needless to say that these arguments which were advanced against the 1s. 4d. ratio in 1898 were exactly those which were urged against the 1s. 6d. ratio in 1925-26. Looking back at the controversy, in the light of events, we find that the Fowler Committee was right in deciding against them. We can see that there had been some fall of prices after 1893, though any statistical measurement of the degree of adjustment is rendered impossible by the famine conditions of the later part of the period, which not only raised many prices directly but also led to the emergence of a lot of rupees from the hoards. The adjustment would have been much more evident, and the fall of prices would have been much more pronounced, but for the abnormal factors mentioned above. As it was, there were reliable witnesses before the Committee who testified to a fall of prices.

There was also a good deal of discussion as to the effect of the higher ratio on the fortunes of the agriculturist. It was objected that to raise the value of the rupee was equivalent to increasing the indebtedness of the agriculturists, and to levying an unfair tax on production in India while giving a bounty to the importer. It was pointed out in answer in the evidence that the hypothesis as to the increase of the burden of indebtedness did not take account either of the long continuance and systematic renewal of the older agri-

(1) Fowler Committee's Report, paragraphs 64—65.

cultural debts, nor of the fact that much of the new indebtedness had been incurred when the rupee was very near the level of 1s. 4d.[1] As against the argument that under a 1s. 4d. ratio the rupee was appreciated, and this implied heavier taxation of the agriculturist, it was pointed out that the settlements had been effected over periods during which the rupee had been as high as 1s. 9d. or 1s. 6d, and hence a rise of exchange from 1s. 3d to 1s. 4d. would mean no material injustice.[2] Finally, the rapid increase of exports, which was beginning to take place with the rupee at 1s. 4d. did not lend any support to the view that the local producer was penalised or that imports were receiving a bounty.

To the general contention that a ratio of 1s. 4d. would adversely affect the trade and production of India, the Committee replied that with a 1s. 4d. ratio the total volume of the export trade of India "had exceeded that of all past years", and that a return to a lower rate would mean a rise in prices and a depreciation of currency. Such a depreciation might for a time give a temporary advantage to some of the producers of India but that it would not mean any gain to the country as a whole".[3] On this subject the Committee had had the advantage of relying on Prof. Marshall's pronouncements on the subject. He had observed that "a rupee at 1s. 4d. is a workable compromise; and although I have seen it stated that it is a tax upon trade, I have not been able to see that it is any tax upon trade at all. It is a tax upon those who have a specific quantity of rupee to pay under contracts made or implied during the very short time that the rupee was of a lower real value than now; but so far as future trade is concerned it seems to me to be a change exactly like the adoption of the decimal system and using the Kilogram instead of the pound". Prof. Marshall also pointed the fallacy of confusing the interests of the enterpreneur with that of the

(1) Q. 10,680—10,688.

(2) Q. 5,773—5,775.

(3) Fowler Committee's Report, paragraph 64 and 68.

export trade of the country. A depreciating exchange benefits the enterpreneur or undertaker by enabling him to gain at the expense of employees and capitalists.[1] But it is a mistake to regard the interests of the enterpreneur or undertaker as co-extensive with those of the trade, especially as under the same circumstances he would make the same gain whether he was producing for export or for domestic consumption. Some of the pronouncements of Prof. Marshall before the Committee represent important stages in the progress of monetary theory. The student of the proceedings of the Fowler Committee can scarcely resist the temptation to study, however briefly, some of his valuable dicta.

Currency ideals and aims of the Committee

It has been observed, on good authority, that the recommendations of the Fowler Committee were influenced materially by the evidence given before it by Prof. Mac Leod. The parallel between the Committee's proposals and those of the Professor is indeed, very close and illuminating, both the analogues and the differences throwing much light on the intentions of the Committee. In fact, we possess a useful commentary on the Fowler Committee's proposals in Prof. MacLeod's evidence before it. The Committee's main object was to set up a Limping standard on the model of that obtaining in France and United States of America, which are "the two principal instances of countries with a gold standard and currency which admit silver coin to unlimited legal tender".[2] This was the opinion of MacLeod, too, and both he and the Committee looked forward ultimately to a time when the legal tender quality of the rupee might be restricted. He urged that "the silver should be maintained as unlimited legal tender for a considerable time until India is sufficiently saturated with gold. When that is done, I think that silver should be restricted as legal tender to an amount considerably exceeding the largest transactions of the poorer natives—

(1) Q. 11,787; 11,834—11,836; 11,842.

(2) Fowler Committee's Report, paragraph 57.

say £25." Indeed, he was hopeful that the limit could be brought down even to £10.[1] The Committee paraphrased this with characteristic caution in observing that, "for some time to come, no such limitation can be contemplated on the amount for which 'Rupees' should constitute a legal tender."

The next important recommendation of the Fowler Committee that the Government of India should accept no obligation for convertibility of rupees into gold", was also supported by MacLeod's arguments and views. He urged that in no country in the world is silver convertible into gold at the will of the holder.[2] He also added that "if such an idea was adopted, it would simply mean that a gold currency could never be restored to India; for a considerable number of rupees and notes could be presented for redemption". He went indeed further, and laid down the extreme proposition that "convertibility was not necessary to maintain the par between rupees and sovereigns."[3] On the other hand, the Committee showed itself far more cautious and far less sanguine about gold coins finding their way into general circulation in India for a long time to come. They, therefore, emphasised the necessity of at least a partial redemption of the rupee, and recommended the formation of a gold reserve, of which the principal use was "that it should be freely available for foreign remittances whenever the exchange falls below specie point".[4] They thus indicated unmistakably that in their opinion a limping standard of the French type was a distant ideal, that the pushing of gold currency into circulation would require a long time, and that meanwhile the rupee was to be kept at par with the sovereign not by virtue of the large proportion of gold coins in circulation but by the instrumentality of a redemption fund.

(1) Q. 12,940.
(2) Q. 12,962.
(3) Q. 12,938 and 12,960.
(4) Fowler Committee's Report, paragraphs 50 and 59.

It has often been proposed that the proper way to promote gold currency is that the Government should resolve on a stoppage of silver coinage. This would, however, mean, in the first place, that public preference in the matter of the currency which it would use is to be disregarded; in the second place, that monetary stringency was to be created in order to force gold into circulation. The Fowler Committee wisely avoided such a procedure, and adopted a tentative method. "The Government should continue to give rupees for gold, but fresh rupees should not be coined until the proportion of gold in the currency is found to exceed the requirements of the public."[1] Very similar was MacLeod's advice to the effect that "the Government should keep the coinage of silver entirely in its own hands. It can then extend or restrict the coinage of silver as it may deem necessary and expedient for the wants of the people."[2]

On many other points the student of the Fowler Committee Report will be enlightened by a reference to Mac Leod's evidence. Thus we find the Committee rejecting the Lindsay scheme on the ground that "any system of gold standard without a visible gold currency would be looked upon with distrust" (cf. para 53 of its Report). This reminds us of the more emphatic, if unscientific, dictum of Mac Leod that "you cannot have a gold standard without a gold currency. I cannot imagine their being separate".[3] Then again, both the Committee and Prof. Mac Leod regard the danger to a gold currency from hoarding to be fanciful. The arguments for fixing the ratio at 1s. 4d. are also common to both,[4] and consist mainly of the disturbance of trade and business that would be caused by having another ratio. Finally, the grounds for rejecting the idea of any "natural or normal ratio" between the rupee and the sovereign are identical.[5]

(1) Fowler Committee's Report, paragraph 60.
(2) Q. 12,947.
(3) Q. 12,945,
(4) Report, paragraph 65, and Q. 12,941.
(5) Fowler Report paragraph 68, and Q. 12,943.

But on one very important matter Mac Leod showed himself more far-sighted than the Committee. Curiously enough, the necessity for securing large gold resources to serve as the basis of the inauguration of a gold currency in India was more obvious to the theorist than to the Committee consisting of practical men. While the Committee left the problem of providing such resources in a very hazy condition, Mac Leod put forward definite suggestions for securing them. For one thing, he suggested that Customs duties should be made payable in gold. He would also not rely exclusively on the opening of the mints to gold to induce a gold coinage. He proposed to offer a bonus or premium upon gold which would be brought in for coinage to ensure a flow of gold to the mints.[1] These measures might be considered by many of doubtful efficacy; but they showed the importance of inaugurating a gold currency policy by gathering large gold resources. They also showed that special incentives were required for inducing people to take the hoarded gold to the mints—important considerations which the Committee passed over in its recommendations.

In view of the controversy regarding the intentions of the Fowler Committee, the above comparison and contrast of its views with those of an uncompromising advocate of gold currency like Mac Leod is illuminating. The Committee while agreeing with many of his views differed from his opinion that gold circulation would reach large proportions in India in a short time. Rather they emphasised the great time needed for such a process. Nor did they regard that the position of India as a Limping Standard country would be the same as that of France. They were aware that there would always be a very large proportion of rupee circulation in India,[2] and that the task of maintaining it at par would require a mechanism not known to the currency systems of gold standard countries like England or France, *viz.*, the Gold Standard Reserve. The Com-

(1) Q. 12968—9.
(2) Fowler Committee's Report, paragraph 50.

mittee saw the need of laying in large gold resources for starting gold circulation; but they did not avail themselves of the somewhat crude proposals suggested to them by MacLeod. However, neither were their own suggestions very satisfactory as regards the matter. For, if a fund raised from the profits of rupee coinage was to be the sole means not only of keeping the rupees at par but also of pushing gold into currency, then the gold coins were not destined to play more than an auxiliary part in the monetary system of India. The existence of such a reserve was dependent on a large rupee coinage, and this latter in its turn implied a small demand for and need of the gold coinage.

Recommendations of the Committee regarding a gold currency.

A careful analysis of these proposals and of the Fowler Committee's recommendations regarding the "effective establishment in India of a gold standard and currency" will show that they hoped to attain this object not at once, but by successive stages; and it is instructive to study the exact character of the proposed stages. The final stage was to be the effective gold standard under which silver would be only a token coinage and would form a limited legal tender only as in the case of the United Kingdom. This was the same idea as that of Prof. Mac Leod, *viz.*, that ultimately India should have a system on exactly the same lines as the British system "which is now universally recognised as the most perfect system ever devised by the ingenuity of man". But the Committee felt that "under existing conditions, for some time to come no such limitation can be contemplated" regarding the legal tender quality of silver. Further, the Committee fought shy of the obligation regarding the convertibility of the rupee into gold.[1] Consequently no course was open but to accept as an intermediate stage of their programme the establishment of a Limping Standard such as prevailed in France.

(1) Fowler Committee's Report, paragraphs 55—57.

Thus the Limping Standard was accepted by the Committee only as an *intermediate stage*, and the parallel appealed to is that of France. But, then, it is to be noted that the special conditions which made for the successful maintenance of the Limping Standard in France were not to be found in India. In France, it was the large circulation of gold coinage which formed the guarantee of the value of the silver pieces. The silver circulation had in fact been greatly reduced in France, and much of the silver was in the Central Bank.[1] The Fowler Committee itself noted how different the circumstances were in India in this respect. It observes emphatically that "there is little or no likelihood, *even according to the most sanguine view*, that *for a long time to come* gold coins, even if declared legal tender forthwith, would find their way to any great extent into general circulation".[2] Here, it was recognised, that even a Limping Standard such as prevailed in France would take a long time to achieve in India. Another difficulty in the way of the introduction of such a limping standard in India was that, while in France there was no further silver coinage, in India the Fowler Committee could only recommend that "fresh rupees should not be coined until the proportion of gold in the currency is found to exceed the requirements of the public".[3] The fact was that the difficulties in the way of the introduction of a Limping Standard were very great in the case of India and that there was no comparison with the procedure adopted by France with that object. France began with the possession of a vast amount of gold which a lucky divergence between the market and bullion ratios of the two metals obtained for that country. Being thus already in possession of the gold required, France had only to stop the further coinage of silver. There was no comparison between her circumstances in 1873 and those of India in 1898. India had before it the uphill task of both acquiring the

(1) Arnaune, *op. cit*, pp. 266—267.
(2) Fowler Committee's Report, paragraph 50.
(3) *Ib*, paragraph 60.

gold and of disposing of the silver currency on a falling market for silver. Obviously India would be faced with a very long and costly process in carrying out the policy.

But if, as the Fowler Report admitted by implication, it would take many years to introduce a Limping Standard of the French type into India, what were their *proposals for the immediate present*? What in fact, was to be the first stage towards the "effective establishment of a gold standard and currency" in India[4]? The first step recommended as we have seen, was that "fresh rupees should not be coined until the proportion of gold in the currency is found to exceed the requirements of the public". But as the Committee believed that the demand for gold coins would be very small "for a long time to come", this recommendation was not inconsistent with the renewal of silver coinage before long. Practically then, at the start, the Committee relied solely on a redemption fund got from the profits of the renewed silver coinage to maintain the parity of the rupee. This fund was to be "freely available for foreign remittances whenever the Exchange falls below specie point."[1] We see thus, that in essentials the system recommended by the Committee for the transition period in the immediate future did not differ in essentials from what came to be called in later years the Gold Exchange Standard; and this circumstances explains the ease with which a transition was effected to that system from the arrangements proposed by the Committee. The economic theorist too will remember that the Committee had added to a Limping Standard the alien idea of a redemption fund, and as such an authority as Prof. Fisher has observed "the gold exchange standard may be regarded as a kind of limping standard with the added feature of partial redemption".[2]

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(1) Fowler Committee's Report, paragraph 59—60.

(2) Fisher, *Purchasing Power of Money* (1911), p. 131.

Discussion of the merits of the Fowler Committee's Report.

In concluding, a reference might be made to some observations on the composition of the Committee from the pen of a very keen student of Indian currency matters—Mr. F. C. Harrison. "The reference to the Fowler Comittee was intended as an appeal from the theoretical to the practical—from experts to men of the business world, or to borrow a legal phrase, from a special to a common jury. And the result has been some what to darken wisdom, for both elements should be present in the tribunal".[1] It might be added that both the strength and the weakness of the Committee arose from this peculiarity of its composition. As a body of practical business men, it was eminently successful in fixing the right ratio between the rupee and the sovereign, and in apprehending its possible effects on trade and industry; it made short work of the complaints and apprehensions of various exporting industries which seemed fearful of their future under that ratio. On all these matters of the repercussion of monetary policy on business interests they held eminently sound views. Their grasp of monetary principles, and their knowledge of the nature and relative merits of monetary standards were less perfect. They advocated the Limping Standard and a gold currency, but they had no clear ideas about the necessary conditions of their success in the case of India; they recommended them, indeed, but did not state the full case for them. They were hesitating as regards the means to be adopted for pushing gold into circulation, and they neglected the provision of adequate resources for that object. A Committee which had just witnessed what large resources Japan had utilised for starting a gold currency or the extent of resources used by various European countries like Austria and Russia for restoring gold standard, should surely have made better provision for the attainment of a similar object in the case of India. The technical and theoretical shortcomings of the Committee also made it certain that it would give a cold and curt recep-

tion to very noteworthy currency proposals like those of Lindsay and Probyn. There is no careful discussion of any of those important proposals in the Fowler Committee's Report, nor is there any recognition of the very similar system then maturing in the Dutch East Indies. Far different was the attitude of the Herschell Commission, which made a comprehensive and careful study of the different possible systems of currency.

Failure of the early efforts to introduce a gold Currency.

After one energetic effort, the idea of pushing gold into currency vigorously had to be allowed to fall into the back ground, for the time being. For this, however, the Fowler Committee was itself responsible in great measure. They had indeed looked forward to the "effective establishment in India of a gold standard and currency;" but the measures for adoption which they recommended were quite inadequate for the attainment of their object. They had failed to see the magnitude of the problem of the introduction of gold currency in India. They neglected the important consideration that a saturation of the non-monetary demands for gold was an essential condition preliminary to gold remaining in circulation. They had provided no fund or resources for serving as the basis of such a policy. They indicated, indeed, that the profit on coinage of rupees should be kept in gold as a special reserve; and perhaps they meant it to be inferred that this was the fund to feed the internal gold circulation in India. But, if this was their policy, it ran counter to their main idea expressed in the same section of their Report in which they argued that "fresh rupees should not be coined until the proportion of gold in the currency is found to exceed the requirements of the public". In one paragraph they recommend, on the one hand, the formation of a special fund for pushing gold into circulation; and yet they imply in the very next paragraph that that fund could come into existence only when the gold in circulation

exceeded the public requirements and further coinage of rupees was undertaken. In fact, there was a conflict here between the policies of starving the rupee circulation in order to pump in gold currency, and that of initiating a gold currency by means of a special fund secured from the profits of the coinage of rupees. One can agree with the latter criticism of the Committee's recommendations that they "did not put the facts together and see their mutual relations", and that there was a certain "latent contradiction in the minds of the members of the Committee" as regards the functions of the reserve fund. The Committee had before it the example of countries like Austria-Hungary, Russia and Japan which provided ample gold resources before going in for a gold standard, and yet it devoted very little consideration to the problem of making similar provision for the success of their own experiment in India.

Not only were the recommendations of the Committee inadequate and vague, but its anticipation of facts were belied by the events. Instead of a demand for gold currency developing itself, there followed a long and sustained demand for Rupees, while it was gold which accumulated in the reserve. It was in fact the great and urgent demand for rupees on the one hand, and the failure of the experiment of 1900 to put gold into circulation on the other, which decided the immediate fate of the Fowler Committee's proposals as regards gold circulation. The measures taken to increase the circulation of gold are described in Government of India's letter of the 6th September 1900. The Currency Offices were "instructed to offer sovereigns to presenters of notes, but to give rupees to any one who might object to receive sovereigns". The agency of the Presidency banks and of the post offices was also employed to pay claims as far as possible in sovereigns. But the response was not satisfactory, and compared to this proof that gold could only be introduced by long continued efforts, the controversy with the Treasury about Indian mints was a comparatively minor factor. The deciding cir-

cumstance was the demand for rupees which began in 1900 with such suddenness and on such a scale, that there was even a failure for a time to cash notes. The rupee portion of the Currency Reserve was indeed depleted for the time being. From the year 1900 to 1906 the correspondence between the Government of India and the Secretary of State is full of the details of the increasing demand for rupees. The conclusion was obvious that the then existing demand for currency was to be met in the main by an increasing stock of rupees. Thus, the proposal of the Fowler Committee for making gold coinage the pivot of our currency system had to be turned down, in the face of the poor response made to the gold currency movement in 1900.

It should be remembered that efforts were made later to push gold into circulation, and, as Sir F. Gauntlett's Currency Report of 1912-13 shows, with greater success; and it is worth investigating why the experiment in gold currency was more successful after 1906 than in the year 1900. The subject does not appear to have received the attention or study which it deserves. The suggestion might be advanced that, in the quinquennium which followed the year 1900, India was feeling the first effects of the great trade boom or cycle which terminated about the year 1907. The year 1900 marked the termination of a period of famine; and hardly was that strain over, when the country had to find the funds for financing large exports growing in volume over a series of years. Such a period of rapid changes and of storm and stress was hardly suitable for accustoming the country to a new currency. The comparative success of gold currency in the year after 1906 was very likely due to the growth in wealth brought about by the earlier boom, and to the more stable conditions of prosperity which had supervened. Even so, it would appear from the Currency Report 1910-11, that the year 1907-08 formed a sort of maximum for the circulation of gold as currency, as shown in receipts by Treasuries, Post-offices and Railways. The circulation then apparently fell off. The experiment is valuable as proving that it takes a long and arduous effort

to introduce gold into circulation even in an auxiliary capacity—though in such a capacity it had a useful part to play under the pre-war Gold Exchange standard. Writing in 1911, Sir W. Meyer noted the failure of the gold currency experiment in 1899-1900. He went on to add "since then however, there has been a steadily increasing demand for sovereigns, and it may be hoped that eventually these will become a medium of circulation to a much greater extent than at present".[1] The interesting experiment was, however put an end to by the war when, under the pressure of circumstances, the gold issues had to be discontinued. Had the war not intervened to interrupt these efforts, or had the report of the Fowler Committee been written at some other time when the demand for rupee could not have been rendered irresistable by the impact of a great trade cycle, gold currency might have taken its place in India as auxiliary to silver and paper. For, even under the Gold Exchange Standard which prevailed before the war, there was room for an auxiliary gold currency.

It has been observed, that every Indian Budget is a gamble in rain, and similarly, the fate of all currency experiments is influenced by the phase and character of the trade cycle. The great depressions of 1873, 1893, 1907 and 1920-21 have all left their marks on the monetary history of India, and so have the corresponding booms. Thus the trade depression of the period 1893 to 1896 very probably delayed the success of the policy suggested by the Herschell Committee; the boom which began a short time before the beginning of the present century rendered it impossible to carry out the proposals of the Fowler Committee in their entirety; and, as we shall see later, the depression of 1920 denied any chance of success to the policy recommended by the Currency Committee of 1919.

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(1) Life of Sir Edward Law, p. 275.

LECTURE IV.

THE DEVELOPMENT OF THE GOLD EXCHANGE STANDARD (1900-1914.)

Origins and analogues of the Gold Exchange Standard.

The introduction of the Gold Exchange Standard into India was part of a great movement for monetary reform in many countries of the world for stabilising their exchanges and for adapting the gold standard to the special economic environment. In the latter part of the nineteenth century many causes contributed to the dislocation of the exchanges, in the case of a large number of countries. There was a break down of Bimetallism, and a deterioration of Silver monometallism owing to the great fluctuations in the relative values of the precious metals. The abuse of paper currency by several countries had dislocated exchanges in their particular cases. Many of the countries in which the silver standard or the paper standard had broken down, owing to these causes, found a transition to the gold standard and currency of the old orthodox type very costly and scarcely possible. But the gold standard admits of degrees, and a method was discovered by which the advantages of a gold standard as such could be secured, even while the internal circulation consisted of silver or of paper. As Nogaro has shown "by a series of changes in method, the traditional gold standard regime evolved into the more modern systems which secure for national fiduciary currencies stable exchanges based on gold". That element of the management of currency which was never absent even under the regime of a gold standard and currency was now given greater importance in order to regulate the supply of the local money and to stabilise its value in terms of gold.(1) The quantity of the local money "is regulated not arbitrarily, but with reference to

(1) Nogaro, *op. cit.*, p. 46.

the world value of gold". Consequently, the expansion and contraction of currency according to the demands of trade is very similar in the case of the Gold standard and currency, and the Gold Exchange Standard when the latter is worked in accordance with its fundamental principles.

In the case of the former silver standard countries, almost the first to adopt the new system was India; and its example was followed by the Straits Settlements by Siam, the Philippine Islands and also by Greece.(1) Even Japan might be said to have often been been upon a variety of the Gold Exchange Standard(2). Among the paper standard countries, the lead was taken by Austria which began its task in 1892 by obtaining gold resources through foreign loans. In the event, the bank of Austria stabilised the exchanges by supplying drafts on foreign countries at suitable rates.(3) Soon after, Russia and Argentine adopted the same monetary system successfully. It is also significant that it was the same trade boom which began after 1896 that assisted, not only India, but Russia and Australia also to stabilise their exchanges and to go on the gold standard. While the majority of eminent authorities like Mr. Keynes, Mr. Hawtrey and Prof. Nogaro insist on the close analogy of the Gold Exchange Standard of India and the systems adopted by Austria and Russia in the nineties, there are a few writers who dissent from that view. But it is not difficult to show the similarity of the monetary systems concerned. In all of them the sale of drafts takes the place of or prevents the exportation of gold. The three essentials of the Gold Exchange Standard—viz., the regulation of the local currency, the gold reserve and the maintenance of the local currency at parity with gold by sale of drafts or gold, when wanted, at fixed rates—were to be found in the case of all the countries mentioned above.

(1) Nogaro, *op. cit*, p. 38.

(2) Economic Journal, March 1925, p. 71.

(3) Nogaro, *op. cit.* pp. 45—46; Hawtrey, *Currency and Credit*, pp. 325—326.

In a recent work of great value to students of monetary theory, the analogy of the Austrian and Russian experiments, mentioned above, to the Gold Exchange Standard system has been again emphasised. Prof. J. W. Angell observes, regarding the former Austrian and Russian currency systems, that "the operation was strictly analogous to the method by which the more familiar Gold Exchange Standard is maintained. But the base was not gold, it was foreign currency units. The power to acquire gold in foreign centres at a virtually fixed price was an incidental result, but in no sense essential to the working of (informal) exchange control" (Theory of International Prices p. 425). In this dictum we note that as regards method—the analogy between the Gold Exchange Standard and the former Russian and Austrian systems is re-affirmed, while in other matters the superiority of the Gold Exchange Standard is asserted. As regards the case of Argentina, the analogy to the Gold Exchange Standard is said to be even more complete, since there "gold was used for international transactions".(1)

The student of economic history can trace back the historical antecedents of the Gold Exchange Standard to the middle of the 18th century. About 1763, some Scotch banks secured the Economy of gold coin by making their notes convertible only into drafts on London.(2) But while this early precedent is interesting to the student of economic history, the example set by the Dutch East Indies was not without direct influence on the future currency system of India. Not without reason has the Dutch East Indies been called "mother of the Gold Exchange Standard", and Java shares with India the honour of adapting the gold standard to the new environment. The Herschell Committee noted that in the Dutch East Indies a gold standard had been adopted, and the silver currency was successfully maintained at an artificial ratio much higher than its market value. On the theoretical side the foundations of the Gold

(1) Angell, *op. cit*, p. 168 and 284.

(2) Fowler Committee, Q. 3,736, 3,745—3,747.

Exchange Standard are to be found in Ricardo's famous Ingot Plan. In the century which has passed since Ricardo expounded his idea, its inspiring character has been amply proved, and a great many monetary schemes have been based on it. Prof. Marshall's plan of Symmetallism was derived from it. So was Lindsay's project of the Gold Exchange Standard, as also the Probyn scheme which was placed before the Fowler Committee. As. Mr. Keynes has pointed out, "after an interval of more than a hundred years, Ricardo's Ingot plan (first outlined in 1811) is in effect adopted" by the Gold Standard Act of 1925. The Gold Bullion Standard proposed by the Currency Commission of 1925 is also based on Ricardo's proposal.

Nature and characteristic features of the Gold Exchange Standard.

It is very necessary to have clear notions regarding the nature and essential features of the Gold Exchange Standard, because controversies regarding currency systems often turn upon definitions and basic principles. By making the definition of the Gold Exchange Standard sufficiently restricted and rigid, and by unduly narrowing the conception of that system, it could be argued (as Prof. Laughlin has done recently) (1) that "the Gold Exchange Standard is not a special kind of standard" but only a transitional phase of some monetary systems; and, indeed, that it has already ceased to function or prevail in almost all the countries in which it had once existed. Prof. Laughlin has advanced the view that it has ceased to prevail in the Philippines in the Dutch East Indies, and in the Straits Settlements; and that even in the case of India the system has lost one of its prime characteristics. (2).

One can safely agree with Prof. Laughlin's dictum that "the nature of the Gold Exchange Standard is made clearer by looking into its origins." Certainly, the essentials of

(1) In the *Quarterly Journal of Economics*, August 1927. (pp. 644—663).

(2) *Ib*, pp. 651—2; 654—5; 663.

that standard are best ascertained by examining its historical back-ground and origins, and the requirements and objects of the various countries, which adopted it. As we have seen, with the disappearance of Bimetallism, the fluctuations of exchange between the gold and the silver standard countries became very disturbing to trade. Silver obviously formed the predominent portion of the currencies of these latter countries, and their object in adopting the new system was to stabilise the exchange by providing suitable machinery for the regulation of their currency, and for its redemption in gold or foreign bills. Consequently, the essentials of the Gold Exchange Standard to which they resorted can be enumerated thus(1) :—

(1) Gold does not form an important part of the local currency. The system of free coinage of silver is suspended "in order to sever the connection between the value of the local currency and that of silver."

(2) The local currency is redeemable in gold or in bills on foreign countries, and thus a fixed value in gold is given to the local currency.

(3) This process of redemption implies the formation of a gold reserve to provide the required gold or foreign remittances. As one aspect of this process of redemption, the local currency which is received in exchange for the foreign remittances or gold is withdrawn from circulation.

Such are the essential features of the Gold Exchange Standard. But, Prof. Laughlin, instead of regarding these main characteristics comprehensively, lays a mistaken and most exaggerated emphasis, upon one aspect of the feature last enumerated, viz., the locking up and withdrawing the superfluous local currency. To him the all-important characteristic of that standard seems to be the supposed postulate that "the parity is to

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(1) Keynes, *Indian Currency and Finance*, p. 30; Nogaro, *op. cit.* p. 37; Conant, *Money and Banking*, vol. I, 279—280.

be maintained by adjusting the currency supply of the currency demand, and not by a system of direct redemption in gold''(1). For him, the whole character of the Gold Exchange Standard is changed if the par is maintained " by the redemption in gold, and not by the change in the quantity of token silver in circulation.'' One can well understand that to Prof. Laughlin who has been the life-long critic of the Quantity Theory of Money, that aspect of the Gold Exchange System in which the supply of local money is adjusted to the demand through contraction or expansion, is the least agreeable. However, to us in India, where the chief criticism of the standard has been that the redemption of the rupee in gold has not been theoretically absolute and perfect, Prof. Laughlin's line of attack is novel but unconvincing. We are here so accustomed to regard ''the system of actual redemption into gold'' as the proper basis of our monetary system, that our withers are un-wrung when Prof. Laughlin assures us that ''the repeated failure of the Gold Exchange Standard is owing to the invalid Quantity theory''. Many of us, indeed, will derive comfort from the thought that our monetary system is broad-based on the Quantity theory, that is, ultimately, on the fundamental law of supply and demand. But, further, it is worth noting, that even a great critic of the quantity theory like Nogaro can be an eminent advocate of the Gold Exchange Standard. It might also be added that the redemption of the silver currency and its contraction are not two independent operations, or antithetical factors, as Prof. Laughlin takes them to be, but only two aspects of the same process. Thus, to take an illustration, the redemption of a country's note issue and the regulation of its supply form only two different aspects of the same process. Nor is the deliberate adjustment of the supply of money to demand a process peculiar to the Gold Exchange Standard. For even under a Gold Currency regime, the manipulation of the discount rate is resorted to in order to influence the supply of currency.

(1) Laughlin, *op. cit*, pp. 645—646; 655.

Having, however, made the assumption that any redemption of local silver currency into gold constitutes a break-down of the Gold-Exchange Standard, Prof. Laughlin finds no difficulty in showing that the standard has broken down in the Philippines, in the Straits Settlements, and in the Dutch East Indies. Indeed, he could have gone on further, and could have argued that the system had never been adopted in India—since we have always had a fair amount of the redemption of the rupee into gold. All this illustrates the harm done by the rigid application of a narrow and inadequate definition.

There is no fear that the Gold Exchange Standard will prove to be only a passing and transitional variety of monetary arrangement. In South America the efforts of Prof. Kemmerer—the historian of the system—are leading to its extension. But in Europe itself, while various countries have been on variants of that standard, monetary opinion has been progressively favourable to the system. Reviewing the monetary theories of the day, Prof. Bruno Moll (of the University of Leipzig) noted in 1917 that "above all, the Gold Exchange Standard is the watch-word of the day." In the enlarged edition of the same work on "Modern Monetary Theories" published in 1926, the same author asks pointedly, "Is it not more than ever the fact that to-day the Gold Exchange Standard is the watch-word everywhere?" And the reason of this approval of the Gold Exchange Standard is obvious; for "this system, based on principles absolutely identical with those of the former *regime* of the gold standard, can also work successfully under precisely the same conditions. If the latter has the merit of bringing international trade back to equilibrium, the same success must necessarily be achieved under a system which involves the same exchange fluctuations within the gold points, and the same automatic changes in the volume of currency in so far as these factors depend in either case on international payments." Moreover, it has proved at least

as efficient as the traditional gold currency system in withstanding the crisis of the great war. There is no valid ground, therefore either on the score of the underlying principles of the Gold Exchange System or of monetary experience for any "hesitation to consider the system as a normal one". [1]

Stages of its adoption in India.

It is very interesting to observe the stages by which the evolution of the Gold Exchange Standard took place in India. [2] For while other countries like the Philippine or Mexico adopted the system as a whole, India led the way and adopted it piece-meal "under the pressure of events". As the Report of the Chamberlain Commissions puts it, the system "has never been deliberately adopted as a consistent whole. To a great extent this system is the result of a series of experiments" [3]. It might conduce to clarity of exposition to indicate these different stages here. The inauguration of the system and the formation of its central mechanism—the Gold Standard Reserve—date from Sir Edward Law's minute of June 28, 1900. Six years later, the efficiency of the Reserve for performing its function of preventing both the appreciation and depreciation of the Rupee was increased by the addition of an Ingot Reserve. Further, from the year 1905 the holding of a portion of the gold in the Paper Currency Reserve in London has reinforced the Gold Standard Reserve in the operation of maintaining the exchange. Such additional support for exchange would, of course, be necessary only in the initial stages, and while the gold Standard Reserve had not been brought up to its full size. Another new factor in the situation—the development of the function of Council drafts—came to facilitate the conversion of the profits on the mintages of rupees into sterling in London, as well as to increase the elasticity of the currency system. Finally, in the

(1) Nogaro, *op. cit*, pp. 210—219.

(2) Cf. Prof. Kemmerer, *Modern Currency Reforms*, p. 122.

(3) Chamberlain Commission's Report, paragraph 45.

matter of the free and prompt use of the Gold Standard Reserve for supporting exchange much was learned from the experience of the crisis of 1907-1908. The idea of redeeming rupees in India in gold was given up in favour of that of the Government definitely undertaking to sell bills in India on London at a fixed rate.(1)

The formation of the Gold Standard Reserve, which has been aptly described as the "pivot" of the Gold Exchange Standard system,(2) was both necessitated and facilitated by the great coinage of rupees which took place after the year 1900. The Fowler Committee had suggested a policy of starving the rupee currency as a means of the introduction of gold coinage. The same policy has been suggested by academic economists in later years, with a similar object. But in practice the very small contractibility of the rupee currency and the special intolerance of deflation manifested by the Indian money market has imposed severe limitations upon such a policy.(3) But the idea of giving a trial to that policy was made quite impossible by the circumstances of the years which followed the beginning of the present century. The rising tide of gold prices abroad, the increased foreign demand for Indian staples and the insistent need for an increased finance for our exports—all enforced heavy rupee coinages and necessitated the formation of the Gold Standard Reserve. For the accumulation of gold in the Paper Currency Reserve had "passed the limits of safety and had brought us into difficulties. As Sir Edward observed, the Currency Reserve was "over-weighted by the accumulation of gold".

To the student of currency development in India Sir Edward Law's Minute of the 28th June 1900 is highly instructive inasmuch as it marked the genesis of the Gold Exchange standard. That document forms the first sketch

(1) Prof. Kemmerer, *op. cit.* p. 121.
(2) Shirras, *Indian Finance and Banking*, pp. 194—195.
(3) Sir J. Brunyate's Memorandum for the Royal Currency Commission of 1925—paragraph 19.

of the new system, and it amply proves the foresight and the financial talent of its author. His merit lay in keeping distinct the functions of the Gold Standard Reserve and of the Paper Currency Reserve. He urged with great justice that "when the funds of the Currency Reserve were diverted from their original purpose and taken as providing security for the maintenance of a steady exchange, a radical and perhaps uncontemplated change was introduced"; and he urged that the policy should be reversed. With that object in view, and also looking to recommendation of the Fowler Committee about the formation of a special reserve for maintaining exchange, Sir Edward Law proposed to limit the amount of gold in the Paper Currency Reserve to seven million pounds as the maximum safe limit. Out of the surplus gold, silver was to be purchased for coinage, and the profits of such rupee coinage were to form the "Gold Exchange fund" (Sir E. Law's Minute, sec. 17). Realising the importance of this fund, Sir Edward Law looked about for means of enlarging it. The Fowler Committee had ruled out Lindsay's idea of borrowing for the purpose (*Ib.* sec 16). Hence the Finance Member fell back on the project of increasing the "Gold Exchange Fund" by adding to it the accumulation of interest on gold investments belonging to the Paper Currency Reserve. In this way it was calculated that, in ten years time, the new fund for maintaining the exchange would rise to four and a half million sterling. In view of the consideration that "however readily saleable our gold investments, they are not quite the same thing as a actual gold" (*Ib.* sec. 26), the new fund was to be held chifly in gold (sec. 20 and 27), although it was contemplated that silver too could be held in it (sec. 30). By implication, the "Gold Exchange Fund" was to be maintained in India.

As it was, the original scheme of Sir Edward Law was modified in several respects by the Secretary of State in his despatch of 13th December 1900. The Gold Exchange fund was not to be located in India,

nor to be held chiefly in gold, but in gold securities at the discretion of the Secretary of State. It was not be increased by the interest on securities in the Paper Currency Reserve. It might be remarked, however, that the original plan of Sir Edward Law would have given a better start to the Gold Exchange Standard, and would have secured a larger gold standard reserve, for he had provided automatic methods of increasing it. It would have also defined better the functions of the reserve, and would have prevented it from being regarded, later as merely a "secondary reserve", with uncertain functions. Law's scheme also involved fewer departures from the Fowler Committee's project, and would have avoided much later criticism.

Sir Edward Law's influence on Indian Currency system

In a brilliant chapter which he contributed to the "Life of Sir Edward Law", Sir William Meyer has justly emphasised the great importance of the influence of Law in the rise and development of the Gold Exchange Standard. As he observes, the three important propositions laid down by Law in the despatch to which we have referred "formed the bed-rock of the currency policy of the Government of India"(1). We have already noted that these propositions related to the formation of the Gold Standard Reserve, the setting of a maximum to the gold in the Paper Currency and the utilization of the surplus gold in purchasing silver for coinage. "Had Sir Edward Law done nothing else of note during his term of office in India, his Gold Standard Reserve policy would by itself have made his tenure of office noteworthy". It was Law's ideal of automatic additions to the Gold Standard Reserve, until it amounted to 20 million sterling, that is here referred to with such approbation. He also opposed the diversion of that reserve in 1907 for railway development in India. It

(1) Life of Sir Edward Law, pp. 270—277.

is true that Law was against the proposal to constitute a great central bank on the model of the Bank of France or Bank of England for the purpose of the effective maintenance of the Gold standard. But that was merely on the ground that circumstances were not as yet ripe for the adoption of that policy; and those who know the great difficulties in the way of the similar proposal put forward in 1912 by the Chamberlain Commission can well believe that circumstances were still less favourable in the year 1899.

Before proceeding with the development of the size and composition of the Gold Standard Reserve, we might deal with some theoretical objections which have been advanced to its institution. It has been argued, on the one hand, that the value of any currency is maintained merely by the limitation on its volume and not by any reserve: on the other hand it has been urged that its size is too small to carry through the process of contraction of currency to a sufficient extent. It is true that the limitation of the currency circulation is the chief object; but there is no better guide as regards the amount of circulation required at any particular moment than the demand for the redemption of local currency or, under other circumstances, the demand for local currency expressed in terms of offers of gold. The demand and supply of the local currency manifestly express themselves through their action on the Gold Reserve fund. The process of contraction or expansion of currency are rendered automatic by the existence of this fund, and need not depend on the arbitrary discretion of any individual. The Gold Standard Reserve forms in fact the sole and indispensable instrumentality for the control and regulation of the volume of currency. Needless to say, it has been found necessary in every country which has adopted the Gold Exchange Standard or any of its variants. And as to its comparatively small size, a reference might be made to the very limited contractibility of Indian Currency as demonstrated by long experience. Even after the crisis

of 1907-08, as Prof. Kemmerer observes, it "still possessed substantial reserve power and it could have withstood a much severer crisis".(1) The automatic growth of the Reserve was insured from the profits of new coinage of Rupees, and we shall see what other steps were taken for strengthening it.

Reverting to the theme of the evolution of the Gold Standard Reserve of India, we come on a very significant and important feature—the formation of a silver branch of the Gold Standard Reserve in order to meet the continuous and great demand for Rupees. It has been argued that "it is wholly diverse from the purposes of the Gold Standard Reserve to use your sovereigns to buy silver"; and the Chamberlain Commission recommended its abolition on the ground that it gave rise to much criticism and was responsible for much confusion and doubt as to the efficiency of the Reserve. With all deference to the Commission, the decisive consideration as regards the mechanism of a currency system is not the popular opinion about it, but its inherent utility. The function of the Gold Standard Reserve is a double one. As Prof. Kemmerer well put it, "the maintenance of the parity is a two-sided operation. The fund has to serve for prevention of the depreciation as well as of the appreciation of the rupee".(2) This point was also emphasised by Sir L. Abrahams before the Commission.(3) The silver portion served also as a thermometer of the demand for Rupees. In transfering this part of the function of the Gold Standard Reserve to the Paper Currency Reserve the necessity for a clear diversion of the functions of the two reserves was lost sight of. "A heavy excess of exports is apt to develop at short notice and to continue for protracted periods in the case of India." So said the Government of India after the experience of over a decade.

(1) Kemmerer, *op. cit.* p. 120.

(2) Kemmerer, *op. cit*, p. 133.

(3) Chamberlain Commission, Q. 694.

They added that "as we regard it, our Gold Standard Reserve silver is a bulwark against hasty coining. It supplements our general stock of rupees when the latter is running low; it gives us time to buy silver at discretion; or if the stringency is temporary, it enables us to carry through without fresh coining until the return of rupees from circulation recommences".(1)

It is necessary at this stage to advert to the transfer to London of a portion of the gold held in the Paper Currency Reserve since 1905. The primary function of such gold was that it was "immediately available for the purchase of silver whenever the need for additional coinage might arise". But it was also made to fulfil the secondary function of steadying the exchange. While such reinforcement of its resources was desirable in the early stages when the Gold Standard Reserve was not yet ample enough, it yet gave rise to the mistaken notion that the gold in the Paper Currency Reserve was the first line of defence for the exchange. It was pointed out to the Chamberlain Commission that, with a properly constituted Gold Standard Reserve, there was no need to rely on the Paper Currency Reserve.(2). Already, the Government of India had emphasised the advisability of holding that it was the Gold Standard Reserve which was our first line of defence against a fall in exchange. Accordingly, the Chamberlain Commission recommended that only a part of the gold in the Paper Currency Reserve held in England should be regarded as a support for exchange, and even then only "as standing behind the Gold Standard Reserve."(3)

The development of the functions of Council drafts and their utilization for the purposes of the new monetary system also require a mention here. While the original object of the system was to transfer funds on Government

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(1) Letter from Government of India to the Secretary of State, dated 29th February, 1912, paragraph 8

(2) Q. 3,663—3,668.

(3) Report, paragraph 117.

account, it became in course of time very useful in the settlement of Indias balance of trade. So far, also, as their use introduced elasticity into the general currency system, they indirectly smoothed the working of the new system. Then, again, as Sir William Meyer has remarked, "in order to obviate the sending to India quantities of gold which the Government of India could not absorb, and which had therefore to be sent to England to procure silver to coin into rupees, the Secretary of State now complies with trade demands by issuing Council bills in excess of what he needs for revenue purposes, and from the excess quantity of gold that he thus obtains fresh silver is purchased for coinage". But, further, the sale of Council bills directly helped the working of the Gold Exchange Standard by facilitating the remittance of the profits on the coinage of Rupees to the foreign centre where the obligations of India had to be met. During the crisis of 1907-08 the agency of the Reverse bills was employed to meet the obligations in London and to transfer the resources of the fund to India; while in the years following the crisis Council bills were utilised to effect the reverse operation.

The Crisis of 1907—1908.

No account of the working of the Gold Exchange Standard in India, however brief, can be complete without a reference to the crisis of 1907-1908. It was a blessing in disguise, inasmuch as it brought into prominence the weak points of the working of the Gold Exchange Standard system in India. The lessons of the crisis were garnered by the Chamberlain Commission. But here it might be noted, as a striking proof of the merits of the Lindsay scheme, that as the result of the experience of 1907-1908 the Indian system was brought nearer the Lindsay scheme in a number of respects. For the time being, "Back to Lindsay" was as valuable a maxim in the sphere of Indian currency, as "Back to Aristotle" has proved in other and more sublime spheres. Almost the whole revision of the Gold Ex-

change system which followed the crisis took place in the spirit of Lindsay's teaching. The principle which was adopted of the prompt sales of Reverse Councils at fixed rates, the abandonment of the policy of redeeming rupees in India in gold, the clearer line drawn between the functions of the Gold Standard Reserve and other reserves and resources of the Government, the recommendation as regards the location of the Gold Standard Reserve, the necessity of holding it to a great extent in gold, and even the movement against the Independent Treasury system were all anticipated in the main, by Lindsay.

But it took some time to draw and apply all these lessons of the experience of 1907-08. The economic theory of the day had not addressed itself to the task of analysing the effects of the movements of world prices, as well as of the various phases of trade cycles upon the currency situation in individual countries. Consequently, the proposals made by the Government of India in the year 1910 dealt only with the currency aspects of the situation. It was proposed to strengthen the resources at the disposal of the Government for the maintenance of exchange in various ways. They were resolved "to lose no time in building up the gold resources of this country". The advisability of holding at least £25,000,000 in gold and gold securities in the Gold Standard Reserve was emphasised and that amount was recognised as the standard. The gold resources of the Government of India were to be further reinforced by increasing the stock of gold in the Paper Currency Reserve. It was also proposed to make further efforts to establish an effective gold currency in India; but it was added that "the difficulty has hitherto been in inducing a conservative people to adopt this form of currency. Shortly before the recent crisis, however, there were signs of encouraging progress in this direction. Though gold was still far from having obtained that popularity which the interests of exchange render desirable, there were indications of a greatly extended use of the sovereign in commer-

cial transaction. This promising development has naturaally received a severe check as a result of recent events". It was also proposed that the sales of Council Bills should be so regulated as to stimulate the transmission of gold to India. [1]

These suggestions were valuable so far as they were aimed at providing India with larger gold resources for the maintenance of exchange. The desirability of having an auxiliary gold currency in India as well as the difficulties in the way of reaching that object were clearly pointed out. But it might be urged that the best argument for such a gold currency was rather its utility in facilitating the adjustment of highly favourable balances (especially when the price of silver was high), than its value in maintaining the exchange when balances of trade were unfavourable. Finally, there can be no difference of opinion as regards the aim that "the coinage of new rupees should be limited as closely as possible," or about the rules made to attain that object. But, at the same time, in the light of a decade of experience, the Government of India were anxious to put on record the necessary dependence of the volume of rupee coinage on trade conditions. They pointed out that "a heavy excess of exports is apt to develop at short notice and to continue for protracted periods"; and that if "the more restrictive view is acted on and the stock of rupees kept low, a sudden outburst of great trade activity may expose the Government of India to embarrassment in the attempt to cope with the demand for currency."

The final consideration and settlement of these important questions had however, to be put off in view of the appointment of the Chamberlain Commission.

The work of the Chamberlain Commission.

One very important feature of its work was that it formally recognised, accepted and improved the Gold Exchange Standard in India. Upto the time of the

(1) Letter from Government of India to the Secretary of State, 30th September, 1909.

publication of the Chamberlain Report, the dicta and scheme of the Fowler Committee still in a sense, held the field. The Chamberlain Report sanctioned the changes made since and laid it down that "the Indian authorities exercised a natural discretion in interpreting the recommendations of the Committee of 1898". The various "examples of divergencies from the scheme adumbrated by the Committee" were enumerated and most of them were justified in the light of events.(1) The affinities of the Indian Currency System to other experiments in Gold Exchange Standard were affirmed and recognized. It was admitted that the system was the result of a series of experiments, and that it had not been "deliberately adopted as a consistent whole." Not only was the new system recognised, but it was improved in various aspects, especially in view of the experience of 1907-08. The proper size of the Gold Standard Reserve was, it is needless to say, a problem of vital importance. With the figures given in Chamberlain Report, we can trace the rise of the amount of the reserve from one million in 1907 to 13 millions in 1907 and 17 millions by the time the Chamberlain Commission was appointed. The events of 1908, however, shook the confidence in the adequacy of the amount. Prior to that the reserve was considered so abundant that of the profits, on the rupee coinage were considered to be safely diverted to be utilised on railway capital expenditure. It seems strange now to be reminded, that a great financier like Barbour defended this diversion and urged that "any surplus in the Gold Standard Reserve in *excess of what is necessary* to maintain the Gold Standard "should be devoted to productive purposes.[2] Temporary loans were also contemplated from silver branch. The crisis of 1908 was useful in dispelling such undue confidence in the size of the Gold Standard Reserve, and proposals had been made to strengthen it. The question then arose as to the proper

(1) Chamberlain Report, paragraphs 45—46.

(2) Barbour, *Standard of Value*, pp. 234—235.

indices of the size of the Reserve. One test suggested was the amount of the circulating medium. This was subjected to some criticism,[1] though it was not pointed out till much later that the amountof Gold Standard Reserve must depend not upon the circulation itself but on the limit of contractibility of such circulation. After the events of 1907-1908, there was a general agreement however that an increase of the Reserve was desirable with the increase of trade.[2] Sir L. Abrahams and Mr. Howard agreed that under the circumstances then existing, the Reserve should be allowed to accumulate upto 25 millions; and later on it should increase further in view of growth of trade. The former figure had already been recommended by Government of India. Other authorities were however against fixing any such limit. As Mr. Marshall Reid put it "it seems to me dangerous to forecast what the requirements in this respect may be in connection with a country like India which has doubled its trade in fifteen years". The Chamberlain Commission refused to set an absolute limit to the accumulation of the Gold Standard Reserve, and expressed the opinion that "even after allowance is made for the ear-marked gold in the Paper Currency Reserve, the suggested total of £25,000,000 is insufficient". This conclusion was based on the ground that the amount of the Reserve "depends not so much upon the amount of rupees at any time in circulation, as upon the growth of India's trade and the extent of the deficiency which adverse seasons or circumstances may at any time be reasonably expected to produce in the country's power to liquidate immediately its foreign obligations".[3]

The Gold Standard Reserve was also rendered immune fromany further diversion; no limit was fixed to the amount up to which it was to be accumulated. The total of gold in

(1) Sir L. Abrahams, Q. 1,074—1,076.

(2) Q. 647—649.

(3) Chamberlain Commission's Report, paragraphs 80—89.

it was to be raised to £15 millions, and thereafter, the authorities were to aim at keeping one-half of the total Reserve in actual gold. The idea was to render India in this respect as far as possible independent of London, and to place India in a position to defend its own financial position, without undue recourse to the Gold Reserves of London. Here, as well as in improving further the composition of the Gold Standard Reserve by emphasising the holding of short dated securities, the advice of the Governor of Bank of England was wisely followed[1]. The resources of the Gold Standard Reserve for sustaining the Exchange was to be reinforced by the gold in the Paper Currency reserve held in London, which was to serve "not as the first line of defence for the exchange, as it has sometimes been called, but as behind the Gold Standard Reserve". A fresh leaf was taken from the Lindsay Scheme, and Government was asked definitely to sell bills on London at the rate of 1s. 3 29|32d., *whenever called upon to do so.* Thus there was to be no failure to utilise the resources of the Reserve properly and promptly.[2] In the annexe to the Report Mr. Keynes emphasised the idea that "the moment at which this reserve is brought into play ought not to depend upon any one's discretion but should be governed by rule".

Statutory regulation of the Reserve.

There remained the very controversial question of the statutory definition of the nature, objects and management of the Gold Standard Reserve. One ground on which such regulation was advocated was the desirability of free sales of Reverse Councils at a fixed minimum figure. It was argued further, that the reserve should be held under regulations which would bring it into use automatically and the public should know clearly what the regulations are. The Commission, however, emphasised the

(1) Q. 3,403—3,410.

(2) Chamberlain Commission's Report, paragraphs 48 and 101.

disadvantages of restricting the freedom of the Government in a crisis, and it argued that public confidence would be secured by a public notification by the Government of their intention to sell bills in India on London at the rate of 1s 3 29|32d., whenever they were asked to do so to the full extent of their resources.

It might be added however, that much of the criticism of the pre-war Gold Exchange Standard system could have been avoided had the Commission seen its way to introducing such a statutory obligation. It was argued later, and on very good grounds, that automatic contraction of currency would have been secured definitely had the Government been under a statutory obligation. For in the absence of such an obligation "Government could arrange by borrowing from the Gold Standard Reserve to meet sterling payments on account of Reverse Councils without affecting the amount of currency in circulation"[1] A statutory obligation to sell reverse councils would have removed all doubt upon this point and strengthened the monetary system materially.

It has also been suggested in connection with the statutory regulation of the Gold Standard Reserve, that the Chamberlain Commission should have provided for the redemption of rupees and notes into gold on demand.[2] No doubt, if such a recommendation had been made and if it had been found possible to carry it out, it would have placed the Gold Exchange Standard in a position unassailable either by business men or by monetary theorists. The demand for a gold currency would have received a counterblast, since there would have been no excuse left for arguing that the country was not allowed to choose its currency. The Gold Exchange Standard and the Paper currency system were fully established by 1913, and the provision for convertibility would have given gold just that

(1) Mr. Denning's Memoranum for the Royal Currency Commission of 1925; and Sir Basil Blackett's reply to Q. 275.

(2) Prof. Kemmerer, *op. cit*, pp. 134—135.

auxiliary position in our monetary system which would have helped in the adjustment of larger trade balances and in reducing the demand for silver when it rose in value. On the other hand, as against Kemmerer's proposal it is to be observed that a pre-requisite of such convertibility would have been an accumulation of very large gold resources sufficient to saturate the public demand for gold and to redeem the rupees coming from the hoards. Now, at a time when the Chamberlain Commission wanted to strengthen the Gold Standard Reserve to a figure much above £25 millions (and to have half of it held in gold), the provision of additional resources for converting the rupees into gold either for internal uses or for export purposes was certainly a very difficult matter to arrange for. Again, under the very difficult circumstances of the war-time such a provision would have greatly encouraged the tendency towards hoarding. Indeed, with the war-time difficulty of securing gold from abroad such a provision would have had to be suspended at once.

Improvements in the Paper Currency System.

The occurrence of the war has deprived the Chamberlain Commission of the credit, which was justly its due, on account of its proposed reorganisation of the Indian Paper Currency. The Commission formed a great plan for remedying the inelasticity of that currency. Recognizing that such elasticity as was then available through the Gold Note Act was but a back-door affair, and only at the expense of the gold reserves of London, it suggested more direct and adequate measures for increasing elasticity. In place of the old principle of having a fixed amount of the fiduciary portion with a metallic backing for all other notes, various other proposals had been placed before the Commission. One suggestion was to fix the fiduciary portion at 40 per cent of the total circulation.[1] Another witness had advocated a proportion of one-third of gross

(1) Sir B. Hunter, Q. 6,457—6,464.

average circulation.[1] The idea had very properly gained ground that elasticity could be secured by making the fiduciary portion of the issue a *proportion* of the total issue instead of a fixed amount. The Commission translated this idea into a recommendation that the fiduciary portion should be fixed at the amount of the notes held by the Government in the Reserve Treasuries plus one-third of the net circulation for the time being. As regards seasonal expansion, which is so necessary in all countries which are mainly agricultural, the Commission did not see its way to accepting a suggestion of Sir Lionel Abraham's for issuing notes against first class bills, but they recommended temporary loans in India through the Presidency Banks. It has of course, been objected that this is a kind of diversion of the reserve which is maintained for the convertibility of notes. But it must be remembered that the loans to the Presidency Banks were only meant to take the place of seasonal expansion of paper currency, and it was only in the absence of a Central Bank for India that this mere palliative was to be adopted. As Mr. Keynes' annexe to the Report showed, the Commission was aware of the objections to the proposals for the loan of funds to existing banks, and it felt that the real solution of the problem was the introduction of elasticity into the credit currency through the instrumentality of a central bank.

The Central Bank idea.

Governor Strong remarked before the Currency Commission of 1925, that the successive Currency Commissions of India had given comparatively little attention banking matters. He might well have made an exception of the Chamberlain Commission in this respect. It was a great merit of that Commission that it saw the vital importance of a central bank in the proper working of any currency system. Indeed, many of the criticisms aimed at the Gold Exchange Standard would have been directed with greater

(1) Q. 8,503.

justice at the absence of a Central Bank for India. The Chamberlain Commission was aware that, as regards the monetary system which they were working on, "the difficulties and inconveniences which arise very largely contingent on the absence of a strong central banking institution, competent to manage the note issue."[1] They went so far as to assert that, in the absence of such an institution which would serve as the pivot of the monetary system those of their recommendations "which relate to the note issue and to the employment of balances may be regarded from one point of view, as palliatives rather than cures." They therefore appointed two of their members—Sir Ernest Cable and Mr. Keynes to draw up a memorandum upon a Central Bank for India. This valuable Annexe to the report anticipated many of the later proposals for improving the currency system by operating it through a central bank. Thus, the note issue was to be managed by the Central Bank and the requisite elasticity was to be secured by a fiduciary issue fixed in proportion to the note issue, while excess issues were to be made possible subject to payment of a tax. As in all European countries, bills were to be "the pivot on which the whole meaning and utility of the note issue essentially turns". The bank was to have the custody of the Gold Standard Reserve; but when the Reserve was to be brought into play for the support of Exchange, the Bank was to act under the Government's order and as its agents.

Rejection of Gold Currency proposals.

The Chamberlain Commission advanced strong arguments against encouraging an increased use of gold in the internal circulation. These arguments are powerful, and, so far as they go, unanswerable. Generally speaking the reserves are, of course, the proper place for gold, and experience had shown that gold in circulation is not available for emergency demands. It might also be admitted

(1) Chamberlain Commission's Report, paragraph 218.

that a gold currency is a needlessly costly affair. Nevertheless, it could be argued, and on good grounds, that under the pre-war Gold Exchange Standard there was room for an auxiliary gold currency, especially under the peculiar circumstances of India. The Chamberlain Commission in fact did not contemplate the possibility of abnormally favourable balances of trade for India, combined with a great rise in the price of silver— a contingency which arose very soon after. Even the moderate rise in the price of silver in the years 1905-1906 led the Straits Settlements and Philippines to protect their silver currency by a series of measures—prohibition of exportation of silver, recoinage of silver coins and admission of other than silver coins to legal tender . But, even in those countries, the prohibition was evaded to a great extent, while as to a recoinage of rupees in India it would be a gigantic operation lasting over many years. Consequently an auxiliary gold currency had a useful part to play under a Gold Exchange Standard system in India.

The critics of the pre-war monetary system of India.

The criticism of the pre-war monetary system in India had been so voluminous and many-sided, that it is a task of some difficulty to present clearly the various lines of criticism and to deal with them individually. As, however, the *locus classicus* for such criticism is Sir J. Begbie's note together with Prof. Nicholson's article in the Economic Journal of June 1914, it seems best to deal with them first, and then to consider later criticism in its proper place.

Professor Nicholson, in beginning his article, admits his great obligations to Sir J. Begbie's note; and, indeed, it might be said that the article is a theorist's version of the discussion in the note. As the Professor himself observes: "the practical side of the issues I wish to raise is dealt with in Sir James Begbie's note of dissent, and I shall treat of the same difficulties with reference to the relative economic principles".

The first reflection that occurs, on a study of Nicholson's able article, is that the complicated problem studied there is assumed in it to be purely a monetary problem and is treated only as such. There is no recognition of or reference to, the great changes that were affecting various items of the balance of trade of India, or to the continuous and great improvement of India's position as regards international trade. Nor was it considered that such a changing position affects very materially incomes and prices within the country concerned. It was also forgotten that, during the period treated of, the world was witnessing a great boom in trade and industry, which was bound to affect the monetary conditions in India—one of the most important suppliers of raw materials of industry in general. All these important factors of the situation were passed over in silence. The procedure adopted was to single out two factors in the situation and to correlate them. On the one hand was the rupee coinage, which the Government was believed to be mismanaging and adding to needlessly and constantly. On the other hand, there was the rise of prices; and the two were connected as cause and effect. The argument that the coinage was "in response to public demands" was brushed aside by him on the ground that, on some other occasions in economic history, the public demand for local currency had seemed to be well founded but that such appearances had proved unreal. It was forgotten that the public demands for rupees India, during this period, very often proved its genuineness by the offer of gold for rupees; that, consequently, "the accumulation of gold in the Paper Currency Reserve had passed the limits of safety"; and that, in view of the suddenness and extent of the demand, a silver Ingot reserve had to be formed. In this connection, a study of the figures for gold in the paper currency reserve in the period 1900-1905 might be recommended to the student.

Prof. Nicholson has argued that "the method of limitation now adopted as regards the issues of the token

rupee is the same as that adopted by the Bank of England in the Restriction. So long as the rupees are issued only in response to a supposed real effective demand, it is thought these can be no depreciation". This view has been adopted by some later economic writers in India. It is forgotten here that a good many of the rupees issued in India were against offers of gold either to Paper Currency Reserve in India, or for council bills in England; and that it was not a case of notes issued against bills discounted as was the case in the Restriction period. Suppose, if possible, during the Restriction period a good deal of gold had come into England as the result of favourable balances of trade, that trade and industry in England had been expanding and that business men had given the gold to the Bank and had taken out notes against it, would that have been considered inflation by Prof. Nicholson or his followers?

There could in fact be no comparison between the trade and currency conditions prevailing during the Restriction period in England and the corresponding conditions in India during the period 1900-1914. During the Restriction period, the English trade conditions were abnormal, with alternating crises, depressions and brief recoveries. England had also to deal at the time with the financial strain of a great war. In the case of India, on the other hand, the financial conditions were prosperous, while trade was improving steadily and continuously. Moreover, it was not a case of a mere local prosperity in India only, but of a general prosperity. So also as Mr. Hawtrey has observed, the financial situation of England in the Restriction period can only be explained by monetary and trade conditions abroad which led to a drain of specie from England.[1] Again, as he goes on to observe, the redundancy of paper currency in England started with the severe credit stringency on the Continent, while English trades-

(1) Hawtrey, *Currency and Credit*, (1919), pp. 261—262.

people received credit fairly liberally. In fact there is very little similarity in the conditions prevailing in England during the Restriction period and those of India in the first decade of the present century.

We turn now to consider the assumption that had India been provided with a gold currency, prices would not have risen during the period. We shall soon take occasion to emphasise the econmic theorem that, whatever might be the currency system of a country, large gains from international trade make a country of higher level of incomes, and under certain circumstances (e.g., inefficiency of labour in certain directions or prevalence of Diminishing Returns) of high prices. These factors would be sure to affect prices even under a gold currency system, especially in an undeveloped country like India producing mainly raw materials of industry which are subject to the law of Diminishing Returns. In the absence of a Central Bank and organised money market in India, the automaticity of a gold currency system (had it been introduced into India) would have been greatly impaired.

Before the war, there were people who held exaggerated notions of the automaticity of a gold currency system. As Prof. Nicholson put it: "In the case of gold, however, there are natural economic forces which in time must limit the monetary supply and so far the level of price". But the constant and increasing pre-occupation of central banks in Western countries before the war with their discount policies and manipulation of reserves showed that, in an important sense, the gold currency system had to be managed, and that it was not so automatic as has been generally supposed. The criticism of the policy of the Bank of England or of the Federal Reserve Board as regards discount and credit policy since the war leads us to the same inference—that the control of credit through discount rate implies management and regulation even under a gold currency system. Since the proper development of central and general bank-

ing is yet to come in India, the gold currency system if introduced in the country would have worked in a halting fashion. But it is further to be emphasised, that in a country like India there are important and special circumstances which would detract further and largely from the automatic character of a gold currency system. On this subject the evidence given by Dr. Sprague before the Royal Currency Commission of 1925-26 deserves to be studied. Thus with the practice of hoarding which exists in this country, an import of gold due to a favourable balance "would not set in motion the corrective influences to quite the same extent that they would be set in motion if a similar amount or amount proportionate to the relative population had been exported, let us say from Europe to the United States". As part of the gold imported would go in the case of India not to the banks but to the hoards prices would rise less, and the corrective influence is not exerted as it would be in the countries where there was no hoarding. So, also, when the balance of trade is unfavourable, gold would first flow out of the banks "making for a strain on such banking machinery as has been developed and, only after pretty considerable strain extracting very much of the gold from the hoards". From all this the inference is clear that the inter-relation of influences which are essential for the satisfactory functioning of a gold standard would be to an important extent wanting in the case of India and the working of the system would be erratic both as regards expansion and contraction.[1] We might admit the force of the argument that the convertibility of the rupee was not theoretically perfect in the pre-war system of India. That of course was not the fault of a gold Exchange Standard system as such; for the pre-war system would have been improved in that direction by a statutory regulation of the Gold Standard Reserve. But it is permissible to show that the alternative

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(1) Royal Currency Commission of 1925-26, Q. 15,351.

system—that of gold currency, if introduced, would also have worked very imperfectly, on account of the peculiarities of the local conditions.

About the time that Prof. Nicholson was writing his article, it could have been noted that in Canada a country on gold standard and currency—prices were being kept for years higher than the world prices, owing to the action of a single factor of its balance of trade—viz., import of capital. Between 1900 and 1912, while prices in Canada rose by 36 points, those in the lending country—Great Britain—rose by 13 points only. Canadian prices also showed an exceptional advance over those of a neutral country—the United States. We see in this case how the persistent action of a single one of the factors in the balance of trade can raise and sustain prices in a gold currency country (and in a country too "with a monetary system of the sensitive type") far above the world prices. As Taussig points out in the same valuable study that single cause had over shadowed all the others.[1] Far more powerful and persistent in the case of India during the same period was another factor of the balance of payments—the persistent and growing excess of exports.

The idea that a gold currency is perfectly automatic and that it insures price stability, has not been borne out by the realistic studies of the price situation in various countries. Reference has already been made to the case of Canadian prices in the period 1900-1914. The following table extracted from the standard work of W. C. Mitchell on "Business Cycles" will show the sustained high prices which prevailed in several gold currency countries during the period with which we are dealing.[2]

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(1) Taussig, *International Trade*, pp. 224—227.

(2) W. C. Mitchell, *Business Cycles*, p. 121.

Average actual prices in 1890-99—100.

Number of commodities. Year	American.		French.		German
	1 Bureau of Labor, revised.	1 Gibson improved.	1 March.	1 Domergue, revised.	New series.
1900	111	112	110	114	113
1901	110	109	105	107	108
1902	114	116	103	106	106
1903	114	115	104	107	106
1904	114	116	103	106	105
1905	116	118	109	107	113
1906	122	123	116	117	121
1907	130	132	119	126	129
1908	121	125	114	112	121
1909	124	132	...	113	119
1910	131	135	...	122	122

In his work on "Monetary Stability", Mr. Bellerby thus describes the rise of prices in Europe during the first decade of the twentieth century: "An abrupt rise of prices occurred in almost all countries effectively applying the gold standard......A further international price movement of some importance occurred from 1909 to 1913, when there was a very gradual but almost continuous upward movement of the price level". Incidentally Mr. Bellerby points out that between the Years 1901 and 1912 prices rose in Great Britain from 70 to 85 according to the Sauerbeck index-number. (Bellerby, op. cit. pp. 98-99).

The notion that gold currency is the most automatic of monetary systems and that price instability is not possible under it, is due, in great part, to the acceptance and application of the Ricardian explanation regarding the

influence of international movements of specie on prices and flow of goods, without paying a due regard either to economic friction or to the element of time. As Prof. Taussig has observed, "the process which the Ricardians pictured is one which takes time. Here, as in almost all their reasoning they neglected the element of time, and assumed that the results which would presumably come, in the long run, do come at once and without a hitch. The mechanism of outflow of money falling prices, increasing exports, declining imports all this automatic re-adjustment does not work out its results in one year or two or three. It has been abundantly set forth in the preceding pages how long a time must be allowed before the eventual consequences appear, before the final readjustment can be expected."[1] It can be therefore expected that even under a gold currency a large import of gold consequent upon a series of good Indian harvests would keep prices high in our country for quite a number of years.

The "sensitiveness" of a monetary system—which means responsiveness of prices to international movements of specie does not in any sense depend directly upon the proportion of gold in circulation. The matter has been well dealt with in Prof. Taussig's masterly study on "International Trade". He shows that the Canadian monetary system is as "sensitive" as any and yet in Canada gold money is almost all in Government vaults. So also the "classic instance of marked and continuing sensitiveness was that of Great Britain before the Great War" and yet in that system, gold "was of less direct importance in effecting payments than deposits". On the other hand, in the case of France with the large circulation of actual gold, there was sluggishness in the response to an international movement of specie".[2] India, no doubt, would

(1) Taussig, *International Trade,* p. 276.
(2) Taussig, *op. cit.* pp. 200—205.

have benefited by the introduction of an auxiliary gold currency, as regards the facilitation of adjustment of abnormal balances. But that would have been the chief gain to be expected from such change. It was not to be expected that a large circulation of gold coin would ensure the "sensitiveness" or the automaticity of the system.

Sir James Begbie has argued that "the recent demand for gold in India shew a loss of confidence on the part of the public in the token rupee". Coming from a former secretary of the Bank of Bombay, the statement was surprising, especially as he must have known of the hoarding of rupees which in those days was on a larger scale than now. So little has there been any distrust of the rupee in India at any period, that those who have advocated the "dethronement of the rupee", from the days of Mansfield and Trevelyan to those of the witnesses before the last Royal Currency Commission, have spoken with bated breath, and under considerable apprehensions, as to the results of the announcement of such a policy. The fact is that with our favourable balances and as long as the foreign investment habit has not been developed the only way of adjusting the favourable balances is by the importation of the precious metals. This state of things has as its results both the heavy coinage of rupees and the hoarding both of gold and of rupees. In fact it is only when the habit of foreign investment takes a firm hold on the people of India that hoarding of specie will decline. It is true that, for a couple of decades, gold has been replacing rupees in the hoards. But that phenomenon is not the result of any distrust of the rupee. It is the evidence of the growing wealth of the hoarding classes and the increase of their resources has led to an enlargement of the unit of hoarding. It is a mere assumption on the part of Begbie and Nicholson that the only or even the main cause of hoarding of gold was the distrust of the rupee, and that, "this late reversion to hoarding on an extended scale is a retrograde movement".

The central fact in the hoarding problem is not the distrust of the rupee—it is the absence of the habit of foreign investment on the part of a country which has usually favourable balances. Our ascetic ideals and our not very high standard of living prevent the adjustment of our balances by the increase of commodity imports. Hence we bring home our favourable balances to a large extent in the shape of silver and gold and the coinage of such silver has a tendency to raise local prices; hence also the difficulty of adjusting the balances when the precious metals are difficult to procure or when silver rises in price. The problem can be envisaged most clearly during the years 1917 to 1920, because it assumed unusually large proportions and every factor in the situation stood out more prominently than ever before. There were a series of highly favourable balances, the import of gold on any large scale was out of the question and silver was rising in prices. There could no possible room for suspicion, that in that case, there was a desire on the part of the authorities to enter on any "fast and furious coinage of rupees". And yet, in spite of all their reluctance and resistance, they had to coin rupees in unprecedented quantities, since there were such rushes for rupees that on occasions inconvertibility of notes was in sight. The position in the war and post-war period was in fact a magnified image of the pre-war situation, and we can readily perceive the necessity of the coinage rupees in such circumstances. It is noteworthy that in the minority Report of the Currency Committee of 1919, Sir D. Dalal pointed out that the best way of adjusting India's favourable balances was to cultivate the practice of foreign investments. While he was entirely in the right in making this suggestion—or rather as he says in adopting it from the Governor of Bank of England—one cannot agree with him that the currency administration of India had anything to do with the absence of the habit of investment abroad or that the Government could have taught the people to invest abroad by stopping the coinage of rupees. That would have meant a refusal to satisfy a

very urgent demand for rupees even at the cost of bringing on inconvertibility of notes.

Prof. Nicholson argued that "after a certain point is reached in the inflation the general depreciation in the purchasing power of the rupee must be followed by a specific depreciation as regards gold; and if this is the case, then the main object of the whole policy is defeated". But he did not explain why, after fourteen years of heavy coinage, the "specific depreciation of the rupee" remained as far off as ever. The only explanation that occurred to him was that, "in general the balance of trade is in favour of India and so long as this balance exists, the volume of rupees can be increased". This unqualified belief in the power of trade balances to keep up the exchange, in the face of long continued inflation and of great changes in relative prices, can not be sustained now. And a very relevant question from the point of view of economic theory would be why the relatively high prices in India allowed favourable balances to continue. The purchasing power parity theory, which so many of the later critics of the pre-war currency standard have accepted, goes entirely against them here; for according to that theory, the rate of exchange between two countries tends to express the ratio between the purchasing powers of the two currency units. Even under the later form of the theory, which regards the parities as "the source of only rather long-run influences" on exchanges, the anomaly of the steady exchanges and high prices in India is inexplicable. For, surely, a decade and a half is a sufficiently long period for the influence of price parities to act on the exchanges.

To avoid, or to explain away, this anomaly a number of suggestions have been advanced. One writer of distinction has expanded Nicholson's explanation by arguing that in spite of the great inflation brought on in India by the heavy rupee coinage, the foreign exchanges were not affected adversely, "because she had certain essential com-

modities which a foreigner is obliged to accept in place of gold.'' He further contends that, owing to the thinness of the connection between the prices of those Indian goods which enter and those which do not enter foreign trade, the prices of the former class did not rise as a result of inflation, though those of the latter class did. As a result, the rupee maintained its gold value in spite of the rise of Indian prices on the whole. Two observations might be made on this line of reasoning. In the first place statistics do not bear out the view that the rise of prices in India concentrated itself of the non-traded goods; for the rise of prices was largest in cases of hides and skins, and oilseeds and oils, with cotton following close on their heels. These are, it is also to be noticed, competitive exports, and the rise in the price of jute which is a monopoly was smaller than in their case. Again the pertinent question might be asked why the foreigner consented to pay larger prices in gold even for the ''essential commodities'' *after* the inflation than *before.*

Similarly, the authors of a valuable and suggestive work on currency and prices in India which has been recently published, offer the following suggestion to show why the inflation of currency in India did not lower our foreign exchanges: ''Some of the articles of export from India are her exclusive monopolies. The monopoly articles can bear a large inflation of prices without endangering their production. Besides, there are many important products in India forming a very large percentage of the total internal trade, which run their life-history within the borders of this country. Their prices may rise very high without calling for any adjustment of the exchange rate or the foreign price-levels. If the currency is inflated, the tendency of the inflation would be to confine its operation to the prices of these monopolies and local products only''.

The argument really comes to this—that it is in the power of India through the instrumentality of inflation

to extract larger prices for its exports from foreign countries—not only as expressed in the local currency—but in gold. For, owing to the alleged inflation, the prices of our exports rose in terms of rupees; and since the exchange has kept steady this means that, as the result of inflation on our part the *gold* prices which we got for our exports have largely increased—increased in fact in proportion to the rise of prices as expressed in local currency. To take an example, suppose as the result of the supposed inflation the prices of raw jute rose by about 50 per cent in rupees between the years 1905 and 1910. Actually, the exchange remains at 1s. 4d. in spite of the inflation; hence the inflation enabled India to obtain 50 per cent. larger price in gold from foreign countries. This, however, is an anomaly. If we were in a position, as monopolists in jute, to charge a 50 per cent higher price in gold why did we not do so earlier? Why need we have waited for the inflation in order to charge the higher prices? It is obvious that in *attributing the increased prices which we got for our exports to the supposed inflation* we are putting the cart before the horse. The rise of prices was due to "the immensely enhanced demand for commodities of export", as has been incidentally admitted by our critics. It is this larger gold price for jute which, translated in terms of the fixed 1s. 4d. exchange, caused us to have correspondingly higher rupee prices for the jute. The extra coinage was in fact a result of the process and not the cause. This inference is strengthened when we find that, in spite of the supposed inflation in India, and the larger prices which had to be paid by the foreigner in gold, the demand for our export staples continuously increased. A country might inflate its currency, but that process cannot enable it to obtain higher gold prices for its wares—let alone induce a growing demand for them. When we consider the rise of the gold prices of a number of articles of our export between 1900 & 1912 we can be certain that local inflation could not possibly be the cause of that phenomenon. Thus, between these years, hides and skins rose by

30 points as regards gold prices, oil seeds rose by over 35 points while cotton and jute were not far behind. The very peculiar dispersion of prices is not accounted for by saying that in the case of India inflation had only a special and limited action and that it "confined its operation to the prices of monopolies and sheltered products only". As has been well put, all countries have their sheltered and unsheltered articles; India is not peculiar in that respect.[1] If indeed inflation in India had concentrated its influence on some commodities of local consumption, leaving the prices of other locally produced goods unaffected, the result must have been that the sales of the former class of goods in India would have fallen off; for the producers of the latter class of articles would not have had the means to buy the goods which alone have risen in value. Unless indeed the prosperity due to "the immensely enhanced demand for Indian commodities of export" had spread itself widely, and had favourably affected most Indian producers, we would have experienced a fall of the demand for many of the articles of local consumption. For, unless Indian producers in general had shared in the prosperity of the epoch, the demand for both locally produced and foreign articles would have fallen off necessarily. There is however no trace or suspicion on such a decline of demand.

In the course of recent currency controversies in India the Quantity theory has been very energetically attacked by some advocates of gold currency, because that theory has been recognised as lending support to the God Exchange Standard. In this connection it might be pointed out that while the Quantity theory forms certainly part of the ground-work of the Gold Exchange system it is also the theoretical basis of the idea of the automatic nature of the gold currency system. For the idea of the automatic character of a gold currency is based upon Ricardo's theorem about the distribution of the precious metals, and this latter

(1) Prof. J. C. Sinha in the *Modern Review*, July, 1927.

is, in its turn a corollary of the Quantity theory. Indeed, one might go further and assert that the very idea of any kind of automatic currency assumes the truth of the Quantity theory. Attention might also be drawn on the other hand to the fact that there are eminent advocates of the Gold Exchange Standard who do not accept the Quantity theory. Thus, to give an example, Prof. Nogaro does not accept the Quantity theory, and is yet a great advocate of the Gold Exchange Standard.

Having dealt so far with the views of the Begbie-Nicholson school we might now advert to the statistical study of the problem by Prof. Kemmerer. That eminent writer has made no partial study of the currency and price problem, but has comprehended in his study other very relevant factors like the volume of production as well as that of trade and the statistics of railway transportation. As a result of his discussion, he finds that between the years 1899 and 1907 the average index number of production in India rose from 100 to 140 and that of foreign trade and transportation from 100 to 165. The conclusion drawn by Prof. Kemmerer might be effected quoted. "Inasmuch as in India the great bulk of business is by means of cash rather than by bank cheques, and as under the inertia of oriental custom there is probably little change in the rate of a monetary turn over from year to year (except in times of famine), this large increase in business to be transacted at a higher price level required a great influx of rupees into the Indian circulation".(1)

The Nature of the Exchange, prices and Currency problem in India (1900-1914).

Contemporary developments of theory might assist us in trying to solve the problem with which we are dealing. That problem consists of an apparently anomalous combi-

(1) Kemmerer, *op. cit.*, pp. 96—99.

nation of high prices, steady exchanges and favourable balances of trade. It has been shown by Prof. Taussig and other eminent economists that a favourable position as regards international trade occupied by a country (owing to an increased foreign demand for its goods) is reflected both in the money incomes prevailing in such a country and, under certain conditions, in her price level. Those countries have high money income "whose labour is efficient in producing exported commodities and whose exported commodities command a good price in the world's markets".[1] The increasing demand from other countries for Indian exports it can be shown gave India such a favourable position in the first decade of the present century.

Contemporary statistics of income tax and wages show a corresponding rise of income in India. As regards the prices of "domestic" goods in such a country, Taussig argues that "the range of domestic prices within a country, as compared with the range of prices of the same things in other countries depends upon the efficiency of labour producing commodities that do not enter international trade". In fact *a rise of prices will follow if the efficiency of labour is comparatively small* in the production of such "domestic" goods, or, one might add, *if the law of diminishing returns is acting* in the production of several of such commodities. It can be easily seen that this line of analysis is applicable to the conditions prevailing in India during the period in question. The increasingly favourable balances of trade since the beginning of the present century, and the changes in the relative values of exports and imports represent a position of increasing advantage in international trade for India. An expansion of currency *followed* —it did not precede-the growth of trade. Soon after the growth of our exports we find an accumulation of gold in

(1) Prof. Taussig, *Principles of Economics*, (Edition of 1911), Vol. I, pp. 503—504. See also the same author's *International Trade*, pp. 27—33, and J. W. Angell, *op. cit*, p. 104.

the Paper Currency Reserve and a corresponding demand for Rupees. Since gold was offered to obtain local currency, we can have no doubt that the demand for local currency was a genuine trade demand. Then, again, many of the peculiarities of the dispersion of prices in India can be accounted for, without any resort to the assumption of monopoly conditions being necessary. For example the very large rise in the prices of food grains and building materials can be fully accounted for by the fact that the additional purchasing power in the hands of a comparatively poor population would first be expended on additional food and housing accommodation. In the case of food grains we have also to take account of the prevalence of conditions of diminishing returns.

The improvement in the position of India regarding foreign trade is obvious from the better prices, which she obtained for a vastly growing volume of exports. Thus the 'Prices Report' shows that owing to the greater rise of the prices of her exports compared to those of her imports, India gained annually over a crore of rupees during the period from the year 1895-1896 to 1899-1900. That grain increased during the next quinquennium to over three crores per annum. It rose to over 14 crores per annum in the succeeding quinquennium, and to the sum of 34 crores of rupees for each of the years 1910-11 and 1911-12. The method adopted has been to take the declared values of the exports year by year and their values at the average prices which prevailed during the basic period; and the same procedure has been followed as regards the imports.[1] These figures give us an approximate idea of the favourable change in the barter terms of trade in the case of India. They show in the first place that "a given physical quantity of imports was purchased for a steadily declining physical quantity of exports", as Taussig would say. They show, in the second place, the

(1) Report on the Rise of Prices in India (1914), p. 139.

period of time when the barter terms of trade began to alter in favour of India *viz.*, about the year 1895-96, which was also the exact point of time when a general business revival followed in the world upon the depression of 1893-94. Thus the price statistics of the Report which we have been quoting are corroborated by the history of business cycles, as indeed was to be expected.

The following figures taken from the official "Index Numbers of Indian Prices 1861-1926" will also help to indicate the improvement in the terms of trade and foreign demand in the case of India during the whole period with which we are dealing.

Year.	Exported articles (28) (unweighted) (Price in 1873=100)	Imported articles (11) (unweighted.)
1899	100	87
1900	124	96
1901	116	96
1902	113	86
1903	103	88
1904	104	93
1905	116	96
1906	139	105
1907	145	116
1908	151	106
1909	133	99
1910	127	109
1911	136	113
1912	145	117
1913	154	117
1914	160	114

Not only India, but all countries mainly exporting raw materials, have been gaining by factors like the fall of freights and the constantly growing demand from industrial countries, as new industries kept starting in these lands. As Dr. Marshall has observed, countries in the position of India "have gained all round: they have gained by lowered cost of transport, and they have gained by the lowered cost of manufacture of commodities for direct use; and that almost equally whether these goods are manufactured by themselves or imported. For competition compels England, Germany and other western countries to give to consumers almost at once the full benefit of any economy in manufacturing processes which they have obtained".

It is evident that the true causal sequence ran during the period from the growing and intense demand for a number of Indian products, through an increase of currency, to the general rise of prices in India. The rise of price in India was due and was able to sustain itself, over a long period because the foreign demand for India's products was becoming more intense; and thus the main factor in the situation—the advantageous position which India occupied in her foreign trade—was steadily becoming more conspicuous, through more than a decade of the world's commercial and industrial prosperity. It is noteworthy, in this connection, that the year 1914 was very likely the last year of a great cycle of prosperity throughout the world. In his study of "Business Cycles", Mr. W. C. Mitchell has noted the general business prosperity of the years 1897-1902 and "the world-wide march of prosperity in 1905 and 1906" ending with the crisis of 1907. After the brief general depression of 1907-1908, of which the effects were felt in India also, there was a revival of world prosperity by 1909-1911.[1] That this increasing foreign demand for India's products (i.e., the growingly advantageous posi-

(1) W. C. Mitchell, *Business Cycles*, p. 78.

tion of India as regards foreign trade) was the main factor in raising and sustaining Indian prices, and that the causal sequence runs from it, is shown by our price statistics. While the large increase of currency in India began after 1905, the prices of India's staple exports had been rising long before that year. Thus, the prices of hides and skins had "gone on increasing continuously since 1890". Oil seeds marked a very great rise of prices in 1900 or even earlier. In the case of jute, prices rose steadily upto 1896 and continued to do so, on the whole, in spite of extension of cultivation. Thus, long before the large coinages of rupees, the growing advantage of India in foreign trade has asserted itself unmistakably in the way of raising the prices of our staples and, on the whole, those articles of trade still led the way as regards prices.

The effects of the great foreign demand for Indian staples and of the cyclical movements of business in the world on Indian currency and exchange are well summarised by Mr. Hawtrey in his masterly work on "Currency and Credit"[1] He argues that "the predominant influence as regards Indian Exchange is the world movement of credit with the consequent alteration of the depreciation and appreciation of gold......The people can absorb rupees when they can sell at high prices, and they can sell at high prices when gold prices generally are high. The jute and cotton crops of 1906 sold at good prices because credit was expanding in Europe.....If Indian traders do not raise their prices they will sell all the more to Europe; if they hoard the rupees that they receive and do not spend them, they will buy all the less; their capacity for absorbing rupees will be augumented in both ways". The effects of the improving position of India as regards foreign trade, and of the cyclical movements of foreign prices, on the absorption of currency and rise of prices in India could not have been better put.

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(1) pp. 339—40.

The same view was emphasised by Prof. Gyan Chand in the course of a memorandum presented to the Royal Currency Commission: "The real cause of the increase of currency was, as already stated, the rising balance of trade in India's favour, which could not liquidate in any other way. The Exchange Standard before the war did not give us stability of prices or provide for temporary expansion of currency but it is wrong to attribute this defect to the absence of a larger volume of gold in circulation or inconvertibility of rupees and notes into gold. The departure from the recommendations of the Fowler Committee, which is often spoken of as a grave offence of the Government of India, may be taken exception to on the ground that the latter drifted into a position the full significance of which it failed to appreciate on account of the absence of a well-defined currency policy; but a stricter adherence to their letter and spirit would not have given us a more stable level of prices or relieved the seasonal stringency in the Indian Money Market. Marshall's well-known analogy that stable exchange is something like bringing the railway gauge of the country in unison with the main line is often quoted in the writings on Indian currency questions, but its full bearing on our economic life is generally overlooked. The commercial contact of India with the world has since 1900 become much closer than before, and the presumption is that the lag of the Indian price level behind the level of world prices has been made up during the period. This fact in itself would go a long way to account for the higher rise of prices in India than elsewhere before 1914, which is so often laid at the door of the Exchange Standard; but as it is difficult to give any statistical evidence in support of the conclusion, it is not given prominence in pointing out the erroneous nature of the arguments used against the pre-war Exchange Standard in India."

We have noted above how the rise of prices in the world and the favourable change in the demand for India's

products led to the maintenance of the higher Indian Exchange as well as to a higher volume of currency and price-level. The rise of exchange was achieved, be it noted, in spite of the severe famine which marked the end of nineteenth century in India. We have now to turn to a temporary situation of the opposite character, and to show how quickly and decisively a world depression can affect the Indian Exchange adversely and can render increments of currency superfluous. It was not merely the partial famine which turned the exchanges against India and rendered the rupee coinage of the year 1907 superflous, but the general depression abroad. For in 1907 there was a breakdown of the credit and banking system in America. In England and Germany, too, it became evident that the climax of the boom had passed and the rise of prices had slackened. These influences made themselves felt at once on the demand for currency in India. As Sir L. Abrahams put it before the Chamberlain Commission, "there has been one occasion when it may fairly be held that there was an excessive coinage of rupees, in 1907, and in order to prevent anything of the kind recurring, a better scheme, and a more economical scheme of coinage has been laid down and is now followed".[1]

Theory of the Inter-relations of movements of money, prices, and exchanges.

It seems desirable to proceed further and to glance at the contemporary developments of economic theory as regards the inter-relations between price-levels, balances of trade and exchanges. In the works of Mill and Goschen the rate of exchange and the price level were believed to be fundamentally determined by the balance of payments. During the last decade, the pendulum swung towards the opposite extreme; and, under the inspiration of Cassel, the determination of exchanges was ascribed to the state of relative prices absolutely—the balance of international

(1) Q. 885.

payments being denied any say in the matter. Prof. J. A. Angell informs us in his illuminating study of International Prices that "the new theory has met with a wide and in the main quite uncritical acceptance in England".[1] It might be added that in India, too, some economists have accepted it too whole-heartedly; and it has been mainly utilized, so far, as a weapon against the Gold Exchange Standard system. Tables have been compiled correlating the rise of the volume of circulation and the price index numbers, while factors like the balance of payments are denied all influence in the matter. But no attempt has been made to go back to the main factor of which prices, Exchanges and balances of trade are all the common products.

The theory of Cassel, however, did not long remain unchallenged in its first and cruder form. True, the older idea of the balance of payments being the only factor which determines the rate of exchange was not revived. But a number of economists criticised the views of Cassel, on the ground that purchasing power parity was itself a function of the rate of exchange. Consequently, as Nogaro pointed out "no certain conclusion is to be drawn from a fairly general correspondence between the rate of exchange and the respective purchasing powers of a currency on the internal and external markets".[2] On similar lines the theory of Cassel was criticised by Aftalion and more recently by Bonnet. Taking a balanced view of the problem, Bonnet has argued that the foreign exchanges are influenced by a multiplicity of factors which the older theorists did not quite ignore, but which deserve to be stated more clearly. All doctrines, he adds, which systematically attribute the variations of such exchanges to one single factor are false. Neither the resultant of balance of payments nor the price position can be the sole determining

(1) Angell, *op. cit.*, p. 192.

(2) Nogaro, *op. cit*, pp. 153—154.

factor in the matter. Finally, Bonnet emphasised the reciprocal influence of exchange and price levels.[1]

The present position of the great controversy which has taken place during the last decade on the topic, has been admirably described by Prof. J. W. Angell in his work on International Prices: "The first solution tried was the price-parity theory. Experience soon showed, however, that the earlier forms of statement contained many defects, and the price parities have now been relegated to a rather long-run, normative position. Although no complete alternative theory has yet been worked out, the tendency in recent years has been to admit the dominance of the balance of payments and the exchange rates in the field of short-time fluctuations and to seek the common origin of both price and exchange movements in some antecedent general conditions".[2] In the case of India, during the period which we are studying, this antecedent cause has been found to be the increased foreign demand for Indian exports, while, further, the short-term sequence of events runs from the side of the highly favourable balance of trade.

The above considerations lend support to the view advanced in these lectures that in the case of India the ultimate factor dominating the foreign exchanges, prices levels and balances of trade is the world's demand for our staples —which of course depends on the existing phase of the business cycle and the cyclical variations in world prices. The fluctuations of this demand is the great dynamic factor in the economic situation of India at any time. The causal sequence starts with this factor which acts on the balance of trade of India and, though such balances, on the amount of currency in the country, which in its turn exerts its influence on the Indian price level.

(1) Bonnet, *Les Experiences Monetaires Contemporaines*, pp. 171—172.

(2) J. W. Angell, *op. cit.* pp. 198—199.

Thus these various factors are found to be intimately related; and the anomalous situation of rising prices, increasing currency, and stable exchanges which marked the first decade of this century in India is adequately explained. While this is the long-period point of view, there is no harm in saying, from the short-period point of view, that the causal sequence runs from the side of balance of trade. For, with each period of favourable trade balance the absorption of currency in India was sure to grow. The sequence of events during the period can be shown to support this view of the situation. In the case of other countries, where the habits of foreign investment and of the use of paper money are developed, the influence of favourable balances on the currency situation would be smaller. But in the case of India, the favourable balances of trade are brought home in a way which must act directly in increasing the volume of currency and in raising prices.

Thus, in the period of 1900-1914 the favourable balances came first and led to an insistent demand for Rupees. Even as early as the year 1900, we find the Government of India perturbed at the great demand for rupees. That in coining the additional rupees, they acted reluctantly was obvious. They were genuinely afraid of "the evil effects of what may in future turn out to be excessive additions to the coinage". But they had little choice in the matter, as there was an "unexpectedly rapid accumulation of gold in the Currency Reserve". The admittedly rapid increase of the rupee coinage had to continue; since the want of rupees led to the failure of treasuries to cash notes and a discount had appeared on the notes. While, in case of the year 1900 these trade demands were partly strengthened by those caused by famine, the "suddenness and the extent of demands" in later years were on account of growing trade alone. As the best means of guarding ourselves against a sudden depletion of the rupee portion of our Currency Reserve" a silver ingot reserve was formed in order to accelerate the rupee coinage.

The increasingly favourable balance required more coinage for its adjustment and each large harvest required more money for moving it. It is to be noted further that the records of favourable balances had already been made in the quinquennium ending 1903-04, while Indian prices begin their upward ascent markedly only from 1905. Thus looking at causes and effects in the short period, we find that at each step forward, the rise in balances of trade was the condition precedent of increase of currency and rise of prices. But if we take the long-period point of view extending over a decade or more, we see that the increase of foreign demand for India's staples was generally speaking the prime cause and the necessary condition of all the factors in the situation that we are considering—the favourable balances, the maintenance of the exchange ratio and the rise of incomes and prices through the importation of the precious metals.

Our conclusion is that those critics of the Gold Exchange Standard who ascribe the instability of purchasing power of the rupee to the nature of that monetary system are taking a narrow view of the great and complicated monetary problem of those days. There were other great factors in the situation—the growing demand for Indian staples, the want of the habit of foreign investments and the absence of banking development for controlling credit and currency; and the influence of these dominating circumstances is neglected in the line of criticism which we have been examining. We have seen how the absence of the practice of foreign investment tends by itself to an undue enlargement of the rupee currency in the process of adjustment of favourable balances. We have also to remember that the proper regulation of any currency depends largely on the discount policy followed by the central banking institution, and that in the maintenance of the parity of a currency with gold a wise discount policy has a large share. As is well-known there

was no banking institution in India, at the period of which we are speaking, to undertake this duty. It is unfair to neglect all these hindrances in the case of India, which would have materially impaired the efficiency of any other currency system working there under the circumstances. It might be admitted that the currency system as practised in India before the war was not yet perfected; and yet, as Prof. Kemmerer has observed, even so it was far more automatic than its critics—who desired to supplant it by a gold currency system—supposed.

Nor should we forget that in India the development of the Gold Exchange Standard system was cut short by the War. The introduction of statutory regulation for the Gold Standard Reserve, would have gone far to secure the automatic working of the system. Such a statutory obligation—to sell reverse councils whenever needed and to lock up the proceeds of such sales in the Gold Standard Reserve—would have secured that automatic contraction of currency of which the need has so much emphasised. The contraction of the currency would have then ceased to depend on any ones' discretion. In the second place, banking development and centralisation were sure to have been achieved in time, and then our currency reserves would have been no longer divorced from the banking reserves; while the same development of banking would have greatly increased the efficiency of the working of the Gold Exchange Standard. Indeed, a marked development of note circulation under the *ægis* of a central bank might have gone far to relieve the system even from the fear of a rise in the price of silver. The *locus classicus* for the study of this line of potential development of the Gold Exchange Standard is that portion of the evidence of Sir Basil Blackett before the Royal Commission on Indian Currency and Finance of 1924-25 which deals with his idea of making the Indian Currency System automatic.[1]

(1) Royal Commission on Indian Currency (1925-26), Q. 9,989—10,179.

It might be said to form a highly interesting post-cript to the history of the Gold Exchange Standard in India. The first step in this line of development of the system would have been, as we have already seen, the fixation by statute of the gold import and export points "with reference not to sterling only but to gold standard countries generally." That would have made the currency of India as automatic as any other currency in the world. The above step would have been supplemented of course by statutory provisions regarding the utilisation of the reserves. The edifice of reform would have been crowned by giving over the management of the system to a central bank for India whose management of discount policy would have insured the automatic expansion and contraction of currency, as well as the maintenance of exchange within gold points. Any danger from a rise in the price of silver would have been removed, as has been mentioned above, by the gradual substitution of notes for rupees which would have been "convertible absolutely into foreign exchange" or into gold for export. In time, then all future issues of currency would be made against an increase in the holding of gold and, in fact, the paper currency as well as the rupee would become convertible into gold bullion. It is obvious that the line of development thus projected would have ended by assimilating the pre-war currency system of India to the Gold Bullion Standard system based directly on the teaching of Ricardo.

Recent controversy in Europe regarding Gold currency *vs.* the Gold Exchange standard.

To the student of the Indian monetary controversy, which has gone on since the beginning of the present century, it might be interesting to turn to the similar controversy which has been carried on, mainly in Germany, during the last decade or so, and to observe the lines of argument which have been advanced there on the subject by either side. Fortunately for us, while many volumes have been

written upon the subject, Dr. Bruno Moll of the Leipzig University has developed the main issues in a convenient form very recently in a valuable pamphlet, and we express our obligations to him. Much has, naturally been made of the fact that the gold currency system has nowhere stood the shock of the war. But the main emphasis has been laid, as was to be expected, upon the concentration of gold resources in the central reserve under the Gold Exchange Standard, and upon the advantages accruing therefrom. The larger gold reserve which is possible under the Gold Exchange Standard is demonstrated not only to have a greater psychological impression and effect both at home and abroad, but, as it is noted, it becomes less sensitive to gold drains and more capable of withstanding them. One result of this, it is contended, is the possibility of a lower and more steady discount rate under the Gold Exchange Standard. Under the Gold Currency System, on the other hand, given the same circumstances, the central gold reserve must naturally be smaller, and hence the discount rate must be manipulated oftener and more sharply. The greater economy of the Gold Exchange Standard system is also admitted, and it is further pointed out that the proportionately larger gold reserve which is possible under that standard renders possible the "Valuta politik" on more comprehensive lines without any fear of a considerable reduction of the Gold Reserve.

The opponents of the Gold Exchange Standard advance the view that the gold currency system is more automatic in character, while the automatic working of the Gold Exchange Standard depends upon the discretion of the central bank or other currency authority. But, on the other hand, it might be pointed out that the experience of gold currency countries like England, France and Germany before the war, and that of the United States since the formation of the Federal Reserve System shows that the automatic working of the gold currency system is only a myth. For, under it the supply of the currency had

to be manipulated by changes of the discount rate the policy of premium on gold, or sales of securities by the central bank. Another argument has been advanced by Prof. Mises and others against the Gold Exchange Standard to the effect that the general adoption of that system by Europe would perpetuate a state of things under which a very large proportion of gold would be left in the United States and under which the policy of the Federal Reserve Board would play the dominant role. But to this argument the best answer has been given by the recent course of events which show that the process of the distribution of the abnormal gold supply in America is going on effectively in spite of the absence of a gold currency in European countries

LECTURE V.

We have now to trace the reaction of the war on the currency system of India. It is noteworthy that during the first two years of the War the system stood the strain of the abnormal circumstances exceptionally well. The tendency towards the weakening of exchange which was manifested at the first shock of the crisis was met and remedied immediately by the action of the Government in declaring a standing offer, from the 3rd of August 1914, to sell sterling bills on London and to support the exchange by all means in its power, in strict accordance with the recommendations of the Chamberlain Commission. Another improvement on the practice of 1908 was that no gold was given out to private persons. The result was satisfactory, and by 1915 high rates of exchange were ruling.

Problem of the adjustment of Balances of trade.

In 1915 a new phase of the situation became apparent and there arose the problem of the abnormally large balance of trade. India had had to face the same problem at the time of the American Civil War; but the problem had become doubly more difficult during the Great War. There was no possibility now of adjusting the balances by increased imports of the precious metals—especially gold—and the favourable balances of trade, which were much larger than ever, increased in a *crescendo* movement. Consequently there arose an unprecedented demand for Council bills and a pressure on the rupee balances accompanied by a vast absorption of rupees. As Sir L. Abrahams put it, the Secretary of State and the Government of India ceased to command adequate supplies of Indian currency and hence could not maintain the offer to sell Council Bills without limit. Steps had therefore

to be taken to economise the currency. From 20th of December 1916 the Council bills were limited to a fixed weekly amount, and thus, a limit was set to the facilities given for the remittance to India. Another modification of the former system, due in part to the great demand for Council Bills, was the selling of such drafts at fixed rates from 3rd January 1917. This had been rendered necessary by 1917, since "it became clear that a fixation of rates by mutual agreements among the Exchange banks in India could not be attained". From the same date the Council Bills were only sold to the chief Exchange banks and to a few firms of special eminence.

Rise in price of silver.

We have seen above that the rising balance of trade, combined with the difficulty of obtaining gold and the fall in the net imports of treasure, had caused some modification of the older system. But by 1916-17 still another factor had come to the fore which was destined to have a far greater effect on the working of the system. As Sir Basil Blackett has observed "it was essentially the rise in the price of silver which upset the Indian currency system"(1). One important cause of the rise in the price of silver was, of course, the fall in the purchasing power of gold; and another powerful course was the demand of India, and later on of China, for more silver currency. The rest of the British Empire showed also an increased demand, as did some other countries. This great increase of demand coincided with a fall in the production of silver. Hence, through the years 1916 and 1917 the price of silver kept rising, until by August 1917 a point was reached at which the exchange value of the rupee at 1s. 4d. was equivalent to its bullion value(2). This rise and the subsequent increases in the price of silver

(1) Financial Statement for 1923-24, paragraph 25.

(2) Report of Currency Committee of 1919, paragraphs 18 and 22.

necessitated corresponding rises in the exchange. The rupee had cut its moorings with its old rate which had been maintained for twenty years.

But neither this great rise of exchange nor the issue of sovereigns could reduce the pressure on silver. By December 1917 the authorities had been anticipating grave difficulties, and the year 1918 witnessed the most serious runs on the rupee reserves. Even the arrival of the silver from America under the Pittman Act did not reduce the demand for rupees, which continued in the year and was at its highest in December 1918. "In January 1919, we were compelled to consider how far we should restrict the issues of silver at the currency offices. We did not take any legal powers to do so; we simply took our stand on the administrative inconvenience and impossibility of issuing actually over the counter daily sums like 40 and 50 lakhs"(1).

As the price of silver rose further the situation became even more critical. "The difficulty of obtaining adequate supplies of silver to meet the insistent demands for currency necessarily brought the Government of India face to face with the problem of the inconvertibility of their note issue. It is sufficient to say that by dint of various artificial aids, such as the withdrawal of extra-legal facilities for local encashment of currency notes, the prohibition of the export and import of coin and bullion, and of the booking of coin by rail and steamer, and (as soon as victory in the war was assured) by successive turns of the screw in the matter of forcing the use of paper currency, the Government of India managed to carry on, frequently in a hand to mouth sort of way"(2).

An incidental but remarkable result of the rise of silver in price was that the rupee ceased to be a token

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(1) Mr. Gubbay's Evidence Q. 255—256.

(2) Mr. Gubbay's Memorandum for the Currency Committee, paragraph 10.

coin for some time. It might be even said that the standard in India was for some time a quasi-silver standard. Hence we note a close connection which existed between the rate of exchange and the bullion value of the rupee for over three years. The correspondence would have been closer and India would have been even nearer the silver standard if the proposal for moving the exchange value of the rupee upwards and downwards with the value of silver which was advanced before the Currency Committee of 1919 had been adopted.

It is very important and necessary to emphasise the influence of the rise of the price of silver upon our monetary standard, and the close connection between the then high price of silver and the exchange value of the rupee. For some writers have recently contended that there was no real connection between the rise of the price of silver and the appreciation of the rupee in terms of the sterling. They have also adversely criticised the Currency Committee of 1919 for "putting the rise of silver in the fore-front of the causes explaining the rise in the Indian Exchange". It is of course true, as they argue, that the rate of exchange is influenced by relative prices. But it is an error to accept the Purchasing Power Parity doctrine in its earlier and absolute form, and to assert that no other factor except relative prices can influence foreign exchanges(1). In fact, the monetary conditions of India in the period which we are discussing constitute a good case for illustrating the shortcomings of the doctrine as it was first expounded. If the great and growing balances of trade of India were to be adjusted, and the inconvertibility of our paper currency was to be avoided, then more rupees had to be coined. It was in this way that the constantly rising price of silver exerted a direct influence upon the exchange value of the rupee.

(1) For the shortcomings of the earlier statements of the Purchasing Power Parity doctrine, See J. W. Angell, *op. cit.*, 66. 249—300; 153—154.

It was in this sense, as Mr. Keynes put it, that "what has actually been the moving factor in the Indian currency policy has been the shortage of silver". By raising the exchange value of the rupee, he added, "the Government of India would be given the opportunity of paying up to a very high price of silver(1). That was one ground on which Mr. Keynes supported the raising of the rupee exchange. The other reason, which he considered even more important was that the higher ratio would dispel "the danger of the high level of world prices extending itself to India".

As in spite of unprecedented efforts it was not possible to increase the coinage of rupees in proportion to the rising tide of demand, the paper currency issue soon began to expand at a great rate. Between 1914-15 and 1917-18 the (average) gross circulation rose from 64,04 lakhs to 101,77 lakhs. "In 1917-18 the increase was 12½ crores in the average circulation, while in 1918-19.. this increase was 42 crores"(2). Hence by 1920 the circulation was 174 crores. Beginning with the Act 5 of 1915 which raised the fiduciary issue from 14 crores to 20 crores, no less than seven acts carried on the process, until Act 21 of 1920 raised the limit to 120 crores. As the Currency Committee of 1919 summed up the matter, "during this period the gross circulation of notes had increased nearly three-fold, while the percentage of metallic backing has decreased by nearly one-half".

The rapid expansion of the note issue during and after the war, led necessarily to the great increase of securities in the Paper Currency Reserve and to a proportionate reduction of the gold and silver in it. Had it been possible to follow out the recommendations of the Chamberlain Comsion about the composition of the Reserve, the metallic

(1) Indian Currency Committee of 1919, Q. 2,724—2,728.

(2) Cf. Gubbay's Memorandum for the Currency Committee, paragraph 10.

reserve would have reached the size of 100 crores by 1920; but actually it was about 60 crores at the end of 1919.(1) In a valuable memorandum on the subject which at once sums up the lessons of the war and makes valuable suggestions, Mr. H. F. Howard discussed the desirability of limiting the investments to a total of 50 per cent of the average gross circulation of the three previous financial years. As a corollary of this, the metallic reserve would also have a minimum proportion of 50 per cent. as he pointed out further "any issue of rupee securities to the Paper Currency Reserve in India represents a permanent immobilising of that portion of the Reserve." He would also keep in view the desirability of reducing our Treasury Bill holding. He did not contemplate "increasing our permanent rupee investment until our bloated Treasury Bill Investment is reduced to more normal dimensions".(2)

The central problem before the Committee of 1919 consisted of the rising price of silver and the growing and insistent demand for rupees which were causing heavy pressure on currency reserve. Some way had to be found out of a position in which there seemed no course to be open for the Government except to be "saturating India with silver at fancy prices." A circle seemed to have established itself out of which there appeared no means of escape. It consisted of large favourable trade balances, large purchases of silver at fancy prices, and heavy coinage of rupees leading to a further rise of prices. Each year's purchase of silver by India, contributed to a rise of prices of silver for the next. Now that the situation is a matter of the past, we can see that it was a temporary affair. But at the time there seemed to be no way out of the labyrinth of rising prices, favourable balances and purchase of more silver. Criticism has after the event, unduly simplified the problem before the Committee, by isolating individual fac-

(1) Q. 5,647 and Currency Committee's Report, paragraph 79.

(2) Mr. Howard's Memorandum for the Currency Committee, Vol. III, p. 29—37.

tors in the situation—for example, the rise in price of silver—and arguing that each particular factor was bound to be a temporary matter. But the rise in price of silver was but a result of the favourable balances of trade of India; and these latter again, were in their turn bound up with the post-war boom, which seemed to be only beginning when the Report was written. How bewildering the situation appeared at the time can be judged from significant facts like these—that in the Minority report a suggestion was actually made to break the chain of events and make favourable balances impossible for the time, by means of a system of export duties imposed on all our exports indiscriminately; and that a Chamber of Commerce advocated inconvertibility as being the only alternative "if India was not to be the play thing of the silver speculator."

The complexity of the problem before the Committee was increased by the fall in the value of the sterling and by the fluctuations of the Dollar-Sterling Exchange. The fluctuations of the Dollar-Sterling Exchange affected the sterling price of silver in London, and, through it, the Exchange value of the rupee. Any fall in the London—New York Exchange would raise the sterling quotation for silver and would thus increase the value of the rupee in terms of sterling.

Alternatives before the Currency Committee.

The choice before the Committee obviously lay between three courses—inconvertibility of note issue, debasement of coinage and the raising of the exchange ratio. And though there might be controversy as regards how far the ratio should have been raised, there cannot be any doubt that the Committee in recommending a raising of the ratio made the best choice among the alternatives open to it at the time, and adopted the most effective and least risky way out of the *impasse*. How far the ratio should have been raised, and by what stages, are of course controversial

matters. But it can scarcely be disputed that the raising of the exchange rate was a preferable alternative to that of the debasement of the rupee. For, obviously, the currency of India would have been thrown into utter confusion by the issue of a new set of rupees with a smaller silver content, circulating side by side with the older full-weight rupees.(1) Again difficulties introduced by the adoption of inconvertibility would have been scarcely less, while the business circles of India justly regarded the course as a disastrous one. Finally, no one even suggested the only remaining alternative of imposing such restrictions on the import and export of gold and silver as to secure the currency of the rupee as a token coin and the retention of the exchange at the old rate. Indeed, the general idea was that all restrictions on the import and export of silver should be removed as soon as possible. The days of pegging exchanges and of restrictions on the export and import of the precious metals were over.

Coming to consider the alternative proposals before it, the Committee disposed of the proposal for inconvertibility of the note issue by showing that the proposed remedy would be worse than the disease and by urging that "the maintenance of the convertibility of the note issue is a vital part of the Indian currency system". In justice to those who advocated inconvertibility it has to be remembered that they proposed it as a temporary measure only, since they expected that the disappearance of India from the silver market for even a short period would bring about a fall in silver prices. On the other hand, eminent experts like Sir W. Meyer, Sir L. Abrahams and Sir D. Barbour opposed the suggestion on the ground that under it the silver rupee would go to a premium and disappear from circulation, and that convertibility could not be resumed without the accumulation of a large stock of rupees which could only mean

(1) For a clear statement of the case against both debasement and inconvertibility consult the Memorandum of Sir Stanley Reed.

a fresh rise in the price of silver.(1) Moreover, as the external trade of India had to be financed chiefly in rupees, that trade would suffer seriously from even a temporary inconvertibility. Even a "'partial'" inconvertibility would bring with it great drawbacks for it would rouse suspicions of partiality and favouritism and present complicated problems of administration.(2) It is true that inconvertibility had been tried in Egypt as a temporary measure, but the Committee rightly pointed out that "the note-using habit is not yet sufficiently established in India to render the introduction of a similar measure there possible without grave risks."(3) Sir W. Meyer, whose knowledge both of India and of Indian finance was unique thus summed up the dangers of inconvertibility: "there are few things I would not do to avoid inconvertibility, and I would certainly far rather see a soaring value of the rupee than inconvertibility if the former would avert the other".(4)

Nor can it be doubted that the Committee was right in turning down the idea of debasing the currency of India by lowering the silver content of the rupee. All projects of this kind were condemned by the ablest and most experienced witness and on very good grounds. The first consideration to be taken into account was the operation of Gresham's Law, according to which the debased rupees were bound to go to a discount while the older full weight rupees would disappear from circulation.(5) On the other hand, if the old rupees were to be called in and re-minted the process would be a very long one indeed—too long to be of any advantage but sure to engender monetary confusion.[6] The effect on prices too would be of a very undesirable kind. The price level was very high already, and

(1) Sir W. Meyer, Q. 3,143—6,
(2) Sir L. Abrahams, Q. 1,007—1,011.
(3) Report of Currency Committee, paragraph 41.
(4) Sir W. Meyer, Q. 3,255.
(5) Gubbay, Q. 434—445; 458—459; Jevons Q. 4995—99.
(6) Keynes, Q. 2,731—2,732.

any factor which might have increased prices even in the long run was bound to be mischievous. The disappearance for the time of the full weight rupees, and the heavy coinage of debased rupees to fill the gap, would have the further effect of raising the demand for silver.(1) All the objections that were in the way of any scheme for the debasement of the rupee, would also apply to the projects advanced for leaving the rupee as it was, but for using 2 rupee or 3 rupee pieces with a lower proportion of silver in them. The old rupee would of course go to a premium and then disappear, and the currency system would be disorganised by the existence of coins which were too large for daily transactions. It was not along this line that the situation was to be remedied. Some measure was wanted which would act directly on the demand for currency, which would not add to the circulation, and which would lower prices—a measure necessary both in the interests of social justice and of equity between debtors and creditors.

Since the objections were so strong against the other two alternatives, the only course remaining to the Committee was to raise the exchange. Neither inconvertibility nor debasement of rupees were likely to accomplish the object of lowering the high prices in India, nor would they reduce the demand for silver in the long run. The problem to be solved was as complicated and many-sided one. The right remedy to be found was one which would help in the adjustment of trade balances and in the gradual restoration of trade to normal conditions, which would reduce the demand for silver, and finally, one which would help to lower the general price-level. The raising of exchange, in a judicious measure, would alone have the many-sided action that was desired. The course of events indeed did not leave much choice to the Committee, for even while it was in session, silver rose in price very steadily, and correspondingly the Indian Exchange rose from 1s. 8d. in June 1920, to 2s. 4d. in December of the same year.

(1) Keynes, Q. 2,768—2,775.

In the light of events, we might consider it very fortunate that the Committee rejected both the above proposals—inconvertibility of the rupee and its debasement. Because from 1921 on wards India had quite enough troubles to face-the fall of world prices, the adverse balances of trade, the rapidly falling rupee and a great commercial and industrial depression. If to these sources of anxiety had been added a general loss of confidence in either the debased rupee or in the inconvertible note issue, the result would have been disastrous. A ratio which subsequent events rendered unmaintainable admitted of being changed or abandoned; but the upsetting of the old rupee currency or the inconvertibility of our note issue would have taken many years to remedy, and would have been particularly dangerous during the period of deficits which was coming on rapidly.

The choice of the Ratio.

The Committee made a careful study of the important problem of the high prices which were then ruling in India. There are some advantages in the case of a slowly rising price level. But no economist could possibily argue that the heavy and abrupt rise of prices due to the inflation of the war period, supervening on the steady rise between 1898 and 1914, was anything but harmful to the country. It has to be remembered that since 1914 the rise of prices had been 93 per cent in the case of food-grains, and 187½ per cent in case of imported piece goods, while it was 61½ per cent in the matter of locally made piece-goods.[1] Leading Indian economists have recognised the necessity of doing away with the war-inflation, and it was this inflation of which the high prices then ruling were a corollary. Sir Stanley Reed who was one of the foremost journalists of India as well as a keen advocate of the 1s. 4d. ratio observed that "a great deal if not the main part, of the very serious troubles with which the Government of

(1) Appendices to the Report of the Currency Committee, Vol. III, p. 161.

India had to deal in the early parts of this year, in April and May, was due to high prices. *The pinch was terribly severe.*"[1] The adjustment of wages and costs of production to such a steep and continuous rise "however rapid must inevitably be a painful one";[2] there were constant complaints and even statistical demonstration that real wages had not risen as fast as prices. There were food riots in some parts of the country,[3] and an examination of the index number of retail prices of food grains will show how abnormally high these prices had risen in the period 1919-1921 and will explain why "the pinch was terribly severe". Talking of the rise of prices owing to the war inflation a distinguished Indian economist observes that "the price-level had reached such a giddy height that the reports of suicide by men and women who were unable to buy food and clothing were in no way few and far between."[4]

When we look to the course which events were about to take in England and America, and to the tendencies which were developing abroad, we cannot say that the measures suggested by the Currency Committee to reduce prices in India were at all before their time. In England, the Cunliffe Committee had already drawn attention to the necessity of deflation, the British Government had decided in 1919 to follow its recommendations, and by 1920 there was the beginning of that process of deflation which was carried on energetically and systematically through the years 1921 and 1922.[5] In the United States, too, the years 1920 and 1921 were to see a great decline of prices. Indeed, in 1921 in spite of a great influx of gold into that country the circulation declined, by nearly 20 per cent. In the face of these

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(1) Read, Q. 4,259.

(2) Appendices to the Report of the Currency Committee, Vol. III, p. 161.

(3) Sarma, Q. 3,859—3,860.

(4) Dr. Ambedkar, Problem of the Rupee, pp. 250—251.

(5) Bonnet, *op. cit.*, pp. 27 and 52.

tendencies abroad, the anxiety displayed by the Currency Committee for some deflation in India, effected indirectly by the rise of exchanges, was fully justified. Those who believe in the effect of changes in price parities on the course of trade should be the last to condemn the price policy indicated by that Committee or to belittle its necessity and importance. Nothing was to be gained by postponing the task of deflation, and those countries which hesitated and delayed longest in taking it in hand came off all the worse. Inflation and deflation were world phenomena, and the latter was bound to come in the wake of the former. As a leading economic journal has observed recently in commenting on the events of the present decade "it was the inflation and not the inevitable fall of prices which was the real cause of the collapse and depression of 1920-21".

Another factor which weighed with the Committee in raising the exchange was the rising price of silver. The danger to the Indian Currency system from a rise in the price of silver had never before been brought home as it was in 1919. It was necessary to dispel this danger; and the danger could only be avoided in two ways, either by "dethroning" the rupee or by fixing the exchange value of the rupee sufficiently high. The rushes for the rupee which been taking place, during and after the war, rendered the idea of dethronement of the rupee out of the question. The Committee argued that there were from this point of view several advantages in fixing the rate at 2s. (gold). A 2s. rate would ensure the rupee being a token coin even if the price of silver rose to 63d., and that price was not likely to be exceeded except for short and exceptional periods. Again, at the 2s. rate the rupee would be entrenched behind a great deal of the coinage of Europe and America; for in many countries silver has been coined for a long time on such a base that if silver rose above 60d. for any length of time it would pay to melt the coins of these countries.

The anomalies of the history of the production and price-movement of silver were never better illustrated than during the decade stretching from the year 1913 to 1922; and the position was so peculiar both as regards the production as well as the demand of silver that no one was in a position to predict, in the year 1920, when the high price of silver was going to decline. Indeed, the probability appeared to be that the high prices of silver were going to continue for several years longer. As we have seen, the price of silver had been falling very steadily and markedly from the year 1872; and the short-lived rise of the price of silver in 1905-06 could be regarded as only an incidental affair. The curious thing was that, in spite of this great fall of its price, the production of silver had nearly quadrupled during the period. This anomalous development was due partly to the fact that silver was a by-product and partly to the discovery of new sources of supply.[1] After the year 1912-13, however, the production of silver began to decline from its maximum and its price began to rise. The price took sudden jumps in 1916 and 1917. Thus, by the time the Currency Committee came to examine the situation, the rise in price of silver had already lasted for some years. Another anomaly of the situation was that the rise in the price of silver failed to increase its production. It was to be anticipated, of course, that with the application of more capital to silver mining and with the restoration of normal political conditions in Mexico the production of silver would increase. But the settlement of the political troubles of Mexico is well-known to be a business requiring plenty of time; and the destruction of capital in the war and its preoccupation in the work of reconstruction during the post-war period imposed difficulties in the way of an increase in the production of silver. Coming to the demand side for silver, the Pittman Act was a strong factor in holding up

(1) Mocatta, Q. 3,404—3,415.

the price. The stocks of silver in China too were low. India itself with its huge balances of trade and absorption of rupees was a powerful factor in keeping up the price of silver. Consequently there were no signs then that the rise in its price which in 1920 had already continued for about six years was going to prove a short period affair.

What difficulties there were in those days in the way of lowering the ratio of exchange below 2s. will appear from the views propounded by Sir Vithaldas Thackersey, a captain of industry from Bombay whose opinions on economic matters commanded wide acceptance and respect. He was aware that at the time there was no possibility of fixing the exchange at under 2s., but he proposed, that the effort should be made some years later when circumstances might make it possible to fix the rupee at 1s. 6d. As to lowering the exchange from 2s., he observed, "we know we cannot do it at present; therefore as all other countries are suffering this inconvenience of exchange, loss or gain or whatever it is........we must go on as best we can until we find in three or four years that an adjustment will take place, and then we must try to think out where silver is likely to remain". He only insisted that even if silver went up higher the value of the rupee should not be raised above 2s. But, indeed, Sir V. Thackersey only represented the general opinion of the day regarding the *maintainability* of the 2s. ratio. Whatever other criticism had been advanced against that ratio before the Committee, no one questioned the possibility of keeping it up. To crown all, even the author of the dissenting Minute 'does not seem to have laid any particular emphasis on the *impossibility* of maintaining the ratio for any length of time.'

The great importance of the rise in the price of silver as a factor compelling the rise of the Indian exchange deserves to be emphasised and elucidated; and it is necessary to discuss briefly the situation in China as regards silver, and the influence of the demand from that country

in raising the price of silver after the year 1918. In fact, there is an interesting parallelism between the causes and consequences of the Indian and Chinese demands for silver during the period under review. After 1916, China had attempted, like India, to economise in the matter of silver coinage, with the result that in that country also the note-issue had increased inordinately. After 1918, the increasingly favourable balances of trade of China led to insistent and large demands for silver coinage, as had been the case in India. China, therefore, continued to import silver under the influence of the trade activity of the period from 1918 to 1920. The growth of the Chinese exports, the stimulation of the internal trade, the rise of prices in China and the hoarding of silver which were the causes of the great absorption of silver in the case of China after 1918 were all factors which had been acting in the case of India from a couple of years earlier. The great rise in the price of silver after 1918, was thus caused by the combined demands of China and of India. Indeed, as an author who has published a monograph on the subject of the rise in the price of silver, between 1914 and 1920, observes China was the chief author of the rise of the price of silver from July 1919 to January 1920, and that country remained the chief support of the price during the better part of 1920. He adds that "with the month of June 1919 appeared upon the market a new element or factor of firmness in the price of silver which exercised a very potent action. China began to make purchases of increasing importance which were to dominate the market and to push the rate for silver upto the first months of 1920 to heights never reached, until then."[1] We thus see the magnitude of the problem presented to the Currency Committee of 1919 by the price of silver. It was something far more formidable than a mere speculative rise in the price of silver due to the action of India alone that it been sometimes made out to be. The problem of the price

(1) Dr. Andre Pailhas, "L'argent—Metal: La hausse des cours de 1914 a 1920," pp. 137 and 176—177.

of silver was not a simple or isolated problem, but one which was complicated and mixed up inextricably with those of the increasingly favourable post-war balances of trade of atleast two great countries of the East. Back of these balances was the great post-war boom which the world was then witnessing, and of which the end could not be foreseen. The necessary corollary from our study is that, as long as the post-war boom continued, there was no prospect of reducing the demand for and price of silver, nor of lowering the Indian Exchange. Incidentally, it might be observed, that the action of that boom and of the favourable balances upon the whole currency situation in the two great raw-material exporting countries of the East presents a detailed and striking parallel and is instructive for the study of the economic effects of such balances.

The above digression was necessary to show that the rise in the price of silver was due to genuine demands from the two greatest countries of the East—demands which were bound to continue as long as the trade-boom itself. The critics of the Currency Committee were not correct in their analysis when they contended that "the rise in the price of silver was really a mere coincidence due to a large extent to speculation."

It has also to be emphasised that the solution of the ratio problem recommended by the Committee was avowedly a temporary one. In the great economic puzzle which was set to the Committee to solve, the main elements were the high prices and the trade boom in the West which led to record favourable trade balances for India, which in its turn caused a rise in the price of silver and difficulties regarding the Indian Exchange. Now it was obvious that the leading factor in this situation—the trade boom which followed the war—could not be a permanent affair but must come to an end after some years. When the boom ended and the world prices fell, the situation would be changed entirely and the matter would require fresh consi-

deration. The Committee has emphasised its view that the problem should be considered anew if and when there was a great fall of world prices.[1] Many eminent witnesses before the Committee had also emphasised the provisional nature of any possible solution. Thus, as Mr. Keynes put it, "if there was another substantial movement in the world prices, doubtless another Committee would be appointed and the question would again be considered."[2]

Linking the rupee with gold.

During the war the sterling had depreciated and become divorced from gold. Moreover it was not possible to foresee when the two would come together again.[3] The problem then was whether the rupee was to be fixed in relation to gold or sterling. There was only one argument in favour of linking the rupee to sterling, to the effect that the greater proportion of India's trade was with sterling-using countries and the fixing of the rupee in gold would introduce an element of uncertainly in the trade of India with these countries.[4] On the other hand, there were a great many considerations in favour of linking the rupee with gold. Thus, it was pointed out that there was no advantage in allowing the rupee to share the fluctuating fortunes of sterling.[5] As it happened, sterling was stabilised only in 1925; and between 1919 and 1925 sterling depreciated a great deal, so that for a number of years we should have had to submit to a great deal of uncertainty and fluctuations of exchange and to a dependence on the cross rate. Moreover by linking the rupee with sterling, difficulties would be created in the way of the policy of keeping the sovereign as legal tender in India, and of permitting free

(1) Report of the Currency Committee, paragraph 51.

(2) Q. 2,763.

(3) Keynes, Q. 2,694.

(4) Abrahams, Q. 5,268.

(5) Keynes, Q. 2,694.

export and import of gold coin and bullion. Finally, it was very desirable to terminate the regime of the Sterling Exchange Standard and to go back to that Gold Exchange Standard which had been established so long in India. The Committee saw the anomaly of keeping India either on a quasi-silver standard or on a sterling exchange standard, and resolved to restore the gold exchange standard. On the whole, the balance of advantage was decidedly with the recommendation of the Committee to link the rupee with gold. It was an idea which was destined to be developed and expanded a few years later. The possibility of a divergence between gold and sterling such as had been witnessed during the war had necessarily to be kept in mind when improving the monetary standard of India.

Use of Gold as Currency

Another recommendation of the Committee, as regards the merits of which there will be general agreement, is the one regarding the desirability of using of gold as auxiliary currency in India and of thus strengthening the pre-war Gold Exchange Standard. In tracing the monetary history of India, we have seen how often the use of gold as auxiliary currency would have been advantageous in adjusting and liquidating abnormally favourable balances of trade. Then again, the fear expressed by the Chamberlain Commission lest gold currency should expand at the cost of our note issue had become a matter of the past with the growth in the use and popularity of paper currency in India. There was no longer any danger that the introduction of gold currency would be in the way of the progress and development either of the Gold Exchange Standard system or of the paper currency system, since both had attained their period of maturity. Recalling his experience during the war time, Sir W. Meyer advocated an auxiliary gold currency as the best means, on certain occasions, of avoiding the drain on silver.[1] He admitted that in some

(1) Sir W. Meyer, Q. 3,180; 3,184; 3,330.

cases the gold coin had to be pressed or forced upon the people in some provinces, and that in times of crises the issue of gold coin had not been so effective as the issue of silver. Nevertheless he showed that "in those days when we were struggling desperately to keep up the flag in respect of convertibility—the issues of sovereigns helped to save the situation." It was of course true that at some critical stages during the war the sudden effort to use gold as currency resulted only in exacerbating the crisis;[1] but, on the whole, even in such circumstances the use of gold eased the situation and relieved the pressure on silver.[2] The inference which the Committee drew from this experience was that, if there were to be exceptional issues of gold as during the war, they would be taken "as an indication that the Government were in difficulties regarding the provision of metallic currency." The proper way of making gold play the part of an auxiliary to silver under the Gold Exchange standard was to "make gold coin available when it is demanded by the public" in ordinary times. Admitting that the economy of the Gold Exchange Standard system would be detracted from with an auxiliary gold currency, yet the system would certainly gain in security by such an addition. For, in India, the gold exchange standard system as practised before war was constantly threatened by two possibilities—any abnormal rise in the price of silver, and any great difficulty in the adjustment of the balance of trade. The use of gold as "optional currency"—the mints being kept open to gold but no obligation being assumed by the Government to convert notes into gold—would have strengthened the pre-war currency system by adding to its security. The only remaining alternative was to improve and perfect the Gold Exchange Standard and to bring it nearer to the Ricardian ideal of a gold standard, as was done some years later.

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(1) Gubbay, Q. 381—383.

(2) Abrahams, Q. 107 and 116.

Improvement of the Paper Currency system.

It was, however, in the direction of reforming of the Paper Currency system of India that the Currency Committee did its most successful and permanent work. It deserves credit for having overhauled the system and for improving it in many respects. The system of reserve requirements, the composition of the reserve, and the methods of securing elasticity, in all these most important points of the system valuable improvements were introduced. In fact, the note issue was improved as far as it could be in the absence of a central bank to control and manage it. Those who would gather the true objects of that comprehensive reform should study the very valuable memoranda submitted to the Committee by Mr. Howard and Sir W. Meyer. The work of the Committee in this direction was embodied later in the Paper Currency Act of 1920, and needless to say that Act formed a great improvement upon the earlier organisation of our note issue.

The constant increase of the fixed fiduciary issue which was found necessary during the war furnished the *reductio ad absurdum* of the old system of paper currency reserve. Both Sir W. Meyer and Mr. Howard agreed that "a percentage investment provision is far more desirable than the present system under which definite cash figures are prescribed, any modification of which requires *ad hoc* legislation".(1) The Chamberlain Commission had proceeded to some extent in the desired direction, but there remained the difficulty that with a percentage limit system of reserves "a sudden encashment of notes might bring down the metallic reserve below the statutory proportion".[2] To avoid this difficulty both Sir W. Meyer and Mr. Howard proposed to prescribe the percentage on a basis of a 50 per cent average of past gross circulation over three years. The 50 per cent proportion of the metallic portion was however considered

(1) Sir W. Meyer's Memorandum: Appendices to the Report of the Currency Committee, Vol. III, p. 58.

(2) Howard's Memorandum; Appendices, Vol. III, p. 32.

too high by experts like Sir L. Abrahams,(1) and it was reduced by the Committee to 40 per cent of the gross circulation.

Coming to the composition of the Paper Currency Reserve, the main requirements for improvement were "the reduction in the huge proportion of the Paper Currency Reserve which, under special war conditions, was temporarily invested in British Treasury Bills as a substitute for gold";[2] and the strengthening of the specie holding as well as an increase in investments of "a temporary and readily realisable character". The Committee recommended the limitation of the Government of India's securities in the reserve to 20 crores, and the holding of a very large proportion of the fiduciary reserve in short dated securities. The reduction of the swollen amount of the British Treasury Bills and the securities of the Government of India, would remedy the effects of war-inflation on the system of note issue. The variety as well as the liquidity of the securities recommended for the reserve would form a guarantee against depreciation; while, as Mr. Howard had pointed out, the differentiation of the temporary investment into several classes would provide a measure of elasticity as well.

With the object of securing seasonal elasticity an entirely new line of policy was adopted. A new, up-to-date, and effective method of introducing elasticity was introduced. Already before the Chamberlain Commission Sir L. Abrahams had suggested the issue of notes against commercial bills in the busy season.[3] Mr. Howard developed further the idea of a more elastic provision for discounting commercial bills, arguing that "circulation due to discounts of this kind is automatically regulated by the demand for Currency and entirely eliminates any danger of permanent inflation."[4] He however would employ the bills not so much as the basis for emergency currency as forming a part of the normal investment of the paper currency reserve. The Committee was fully aware of both the importance and novelty of the measure which was being

(1) Abrahams, Q. 5,646—5,652.
(2) Sir W. Meyer's Memorandum, paragraph 26.
(3) Abrahams, Q. 5,659.
(4) Howard's Memorandum, paragraph 15.

advocated, and recommended that an experiment be made in the direction by the issue of notes up to 5 crores on the security of commercial bills of exchange—such issue to take the form of loans to Presidency Banks on the collateral security of bills endorsed by them. For very good reasons the Committee recommended that the bills should be *bona fide* commercial bills against goods under export. These reasons were that such bills are more easily identifiable as representing a definite commercial transaction than internal bills which may be created for purpose of finance or against goods held for speculative transactions'', and that they would lead to the automatic retirement of the emergency note issue on their maturity.[1] On the other hand, Sir Lionel Abrahams and some other experts showed a preference for utilising inland bills for the purpose;[2] and by the Act of 1920 inland bills form the basis of the emergency currency.

Criticism of the work of the Committee.

In view of the above examination of the Currency Committee's work we find that a considerable proportion of the criticism advanced against it is wide of the mark. There was nothing for it but to raise the exchange as the price of silver rose, unless either debasement or inconvertibility was to be given a trial in India. That a somewhat higher exchange was also needed in order to cause a desirable decrease in the then price level is also matter for general agreement. The proposal to connect the rupee with gold, and that rgarding introduction of gold as auxiliary currency were also moves in the right direction. The main ground for criticising the Report of the Currency Committee of 1919 is that it somewhat exaggerated the advantages of stability of exchange,[3] and that it urged immediate stabilisation at a 2s. ratio instead of recommending the

(1) Report of Currency Committee, paragraph 80. Das Gupta, *Paper Currency in India*, pp. 207—208.

(2) Abrahams, Q. 5,663.

(3) Report of the Currency Committee, paragraphs 34—36.

more cautious policy of raising the ratio step by step—tentatively testing each step by its influence on prices and on the trade position. Had the rate been raised gradually and by steps of one penny or two pence at a time (as Sir W. Meyer, Sir L. Abrahams, Sir D. Barbour, Prof. Jevons and others had recommended), there would have been less fear of a *debacle.* It has to be remembered however, that, even in that case, there would have been some loss in the sale of Reverse Councils when the price of silver fell and the balance of trade went against India. When one set of abnormal circumstances had raised the rupee so high, and another set was going to fling it low, there was no certain way of avoiding great losses, and as we shall see a loss of resources was sure to result from a rapid fall of the rupee. But, no doubt, had the advice of Sir W. Meyer, Sir L. Abrahams and others been followed India would have been able to cut her losses to an important extent. In fact their evidence before the Committee forms the soundest criticism of the Committee's work.

So great was the eminence of Sir L. Abrahams as a master of monetary practice and so high the praise justly bestowed upon the suggestions which he placed before the Commission, that it is necessary to examine at some length the programme which he recommended to the Committee. Perhaps the same justice has not been done to the equally sound views propounded before the same body by Sir W. Meyer. Here it seems best to discuss together the views of these two great financiers.

The most important point which they urged was that though stability of exchange was a great convenience, it might be purchased too dearly and that it was not worth paying an unlimited price for.[1] It was in fact, secondary in importance to other graver issues involved in the problem. Both Sir L. Abrahams and Sir W. Meyer pointed to the ways in which the inconvenience caused by a fluctuating

(1) Abrahams, Q. 967. Memorandum of Sir W. Meyer, paragraphs 12 and 13.

exchange could be mitigated, and were mitigated before 1893. "Banks would follow as far as possible the policy of the 'even keel' i.e., of equating their homeward with their outward remittance. So far as they were able to do this, they would not at any stage incur any risk of loss by Exchange. But it is necessary to consider the possibility that the Banks might be unwilling to enter into forward exchange contracts with merchants."[1]

The proper policy to be adopted, according to Sir L. Abrahams, was to follow the price of silver upwards by steps so long as it continued to rise. Strong objection was taken to the raising of the rupee from 1s. 8d. to 2s., as a preconceived policy. There was no advantage in being able to say "we are at 2s. and we will never go higher". "A certainty of exchange so secured would produce uncertainty about every thing else". But of course the rupee might be raised even to 2s. 2d. or 2s. 4d. sterling if occasion should arise, and Sir Lionel did not deny that under his plan even a 2s. 4d. ratio was possible.[2] Since there was no certainty, in his opinion, whether the rupee was going up to 2s. 4d. or to fall below 1s. 8d., he was averse to any definite fixation of the ratio. But any early declaration that the rupee was never going lower than the highest point it might reach, was a thing to be deprecated. On the other hand, he advised the Committee not to suggest a priori that some such rate as 2s. or 2s. 2d. or 2s. 4d. was an absolutely outside figure beyond which we ought not to go. At the utmost an announcement might be made that the rupee was likely to be steady at a certain rate and that it was the policy of the Government to keep it steady. In this way, by successive stages, a rate of 2s. might be reached, and if after that trade was adversely affected by the step, or if it appeared that silver was falling, it would be expedient gradually to lower the exchange step by step—"I do not think that we should be able to go down suddenly and to say that the

(1) Memorandum "B" of Sir L. Abrahams, paragraph 9,

(2) Abrahams Q. 5,282 and 5,413,

first step that we took must put us on our final halting place; but we ought I think, to take a step down with the idea that we should be able to stay where that placed us for some considerable time.''[1]

That was also the view of Sir W. Meyer. He urged that it was impossible at the time ''to scan the future with sufficient confidence to lay down a definite, stable and expedient ratio between the rupee and the sovereign, to be maintained, if necessary at the cost of convertibility. In currency as in other matters, we are still in a storm-tossed ocean, and we know not as yet what *terra firma* we shall eventually reach and when. It seems to me far better, therefore, to regard the present as a provisional period during which we should continue to follow the main lines of the present policy.''[2]

The views of Sir D. Barbour,[3] the veteran Indian Finance Member, who had done so much to start India on the gold standard also claim our attention by their soundness. They were thus summarised by the Chairman of the Committee. ''The value of the rupee should follow the value of silver upwards by steps, but no declaration should be made as to future policy either by way of fixing the rupee at any particular point or of subsequently reducing its value or not reducing its value. In fact the hands of the Government should be left absolutely free to deal with future circumstances as they arise''.

Had the cautious policy recommended by Sir L. Abrahams and Sir W. Meyer been followed India would have escaped considerable financial losses. These great financiers displayed marvellous economic foresight; for at the time in the year 1919 when they were giving their evidence before the Currency Committee few could have had any inkling of the economic depression or rather storm which was to burst upon the world in the very next year.

(1) Abrahams, Q. 1,182—1,186.
(2) Sir W. Meyer's Memorandum, paragraphs 14 and 15.
(3) Barbour, Q. 2,055.

The extreme caution displayed by the three great representatives of the monetary policy of India in the midst of the general optimism prevailing throughout the business world of the day is not only a proof of their high financial sagacity but a remarkable illustration of the high degree of care with which the monetary policy of India had been guided in the past. Thus the attitude of Sir D. Barbour in the year 1919 throws much light on his deliberate and cautious policy as regards the closing of the mints. The similar attitude of Sir L. Abrahams reveals the extreme caution with which he guided the development and working of the Gold Exchange Standard. Had the advice of these three veteran financiers been adopted, India would have escaped considerable financial losses. Some loss of resources was of course inevitable. When a great land slide like that of 1920 occurred the country was bound incur some losses. Nevertheless it remains true that *the one mistake of the Babington-Smith Committee consisted in turning down the proposal of the great financiers—Sir D. Barbour, Sir L. Abrahams and Sir W. Meyer.*

But however great one's respect for the views of the eminent men, we must not allow ourselves to suppose that had their advice been followed India would have incurred none of the loss of resources which it actually did in 1920. When a land slide like that of 1920, occurs, a country is bound to incur serious losses. As Sir L. Abrahams frankly admitted, he did not contemplate the possibility of any very rapid lowering of the exchange. In fact, in the descent of the rupee he would have been as deliberate as in raising it. He did not think "we should be able to go down suddenly." "If it was found expedient to lower the rate of exchange it would be desirable to raise the rate for reverse drafts by a step which would bring you to a point at which you would expect to be able to stand, and not to a point from which you would expect to have to move again in the near future." For "if we began by selling reverse drafts at 2s. and then went to 1s. 11d....... and then the

public thought we were going to 1s. 10d. and so on, it would create a sort of unnecessary and artificial demand at an early stage from people who were afraid of being left until the later and dearer stage; so that I think we should have a fixed rate for that 'episode'—by 'episode' I mean the interval that would elapse until the ordinary direction of trade had established itself again—and that we should not be wise to take advantage as against the public of continually raising our prices for reverse drafts".[1] Hence we can infer that had the policy thus contemplated been followed in 1920-21 there would have been no rapid lowering of the exchange—in fact no precipitate retreat but a series of bold occupations of positions. As the result of such a policy there would have been a considerable loss of our gold resources though of course not so large as actually was incurred. What is to be emphasised is that with such an abrupt "landslide" as actually took place, some very heavy losses were unavoidable, whatever the policy that had been followed, even that of Sir Lionel Abrahams; and that it is not quite just to attribute the whole loss that was incurred to the policy recommended by the Currency Committee. Nor could even Sir L. Abrahams correctly guess "the interval that would elapse until the ordinary direction of trade had established itself again." That was to be a much longer process than even he anticipated. In passing we might note his view that "as far as one could tell, generations would have to elapse before a 1s. 4d. rupee could be restored without the gravest injury to India."[2]

Then, again, it will be well to remember that the Committee had the difficult task of judging between the suggestions or intentions of a few practical men of genius like Sir L. Abrahams, Sir W. Meyer, on the one hand, and alternative recommendations also advanced by men of eminence and capacity and backed up by facts and figures up to date. Genius was characteristically, and hence rather unduly, reti-

(1) Abrahams, Q. 1,185—1,186.

(2) Abrahams, Q. 5,418.

cent; and as we have seen, advanced only one argument in favour of the course it recommended—that the world conditions were then in a state of flux. It did not point to any particular factors—prices or balances of trade—from which the danger which it apprehended was to come. Neither Sir L. Abrahams, nor Sir W. Meyer nor Sir D. Barbour analysed the situation as to prices, or balances of trade, or the factors affecting the price of silver. They were certainly in the right, as it turned out; but it could not have been foreseen at the time why or how they were going to prove right.

We shall also be the less critical of the Committee when we remember that its recommendations would have been fairly successful but for the abrupt, unexpected and unprecedented change in the economic situation of the world. As we have seen so often before, all currency proposals are dependent for the success in a large measure on the trade conditions of the day. The experts however had assured the Committee that an increase was to be anticipated in the balance of trade in favour of India. They were of the opinion that the prevailing tendency was to widen the margin of the balance of trade in India's favour. But in fact, and for the time being, it turned out just the other way round. Eminent economists had also expressed the view before the Committee that high world prices were likely to continue and that even a further rise was very likely.[1] Assuming that the relative prices would keep stable at the level of 1919, they went a long way to support the 2s. ratio in gold. As Mr. Keynes showed later, the prices outside India had risen high enough in 1919 to justify a 2s. 3d. ratio. There had been far more proportional inflation in other countries than in India, and deflation abroad did not begin for sometime after the publication of the Committees' Report. The index numbers in England were still making new records at the end of 1919 and even for sometime after. Thus, between January 1919

(1) Keynes, Q. 2,636—2,645, and 2,762.

and January 1920, the *Economist* Index number showed a rise from 265·9 to 353·1. Even late in 1920 economists of repute could speak of "the present dilemma in which it is virtually impossible to check the tide of rising prices, without paralysing trade and industry."[1] It was also asserted, on high authority, that there was likely to be a further rise in world prices. For one thing, there was "a good deal of unrealised potential inflation which has not yet affected prices." Then again, it was believed that various administrative restrictions in almost all countries were as yet keeping down prices. It thus seemed very likely that for many years to come the relative prices would be such as to maintain a 2s. ratio. But as it turned out, in two years, prices in leading countries like England and United States were just halved. As regards silver, there was a remarkable unanimity of opinion among the experts that its price was going to remain at the then high figure and that any decline in it would take many years to come.[2] As it was, however, the same year saw silver at 84d. and at 38d. No Committee, unless it was composed of super men, could have foreseen such a world cataclysm, which suddenly and simultaneously cut away all the props of the raised Indian Exchange, and which reversed every tendency which had been leading to its rise. Neither governments, business men nor economists were at all prepared for the aftermath both of the War and of the unwise political and economic arrangements of the Treaty which closed that war

In a memorandum written for Royal Currency Commission (1925-26), Prof. P. C. Basu thus stated his opinion about the policy followed in India in 1920: "It must, however, be remembered that all the above calculations rested on the assumption that an inelastic demand leading to a high price level would be maintained for some time in Europe, so that enough time would be left for Indian prices

(1) Mr. H. D. Henderson in the *Economist* for 11th September 1920.

(2) Carpenter and Cullis, Q. 4672-5; Memorandum of Mr. E. L. Mocatta, paragraph 3.

to adjust themselves to the new forces. After this internal adjustment there could, of course, be no effect of the exchange rate upon the trade and production of the country. Thus the crux of the whole thing lay in the then existing high prices in Europe. All experts said that they would remain so for a period much longer than what India would require for adjustment within itself. But we, who are now wiser after the event, know that prices began steadily to fall from 1921. The main reason is, of course, the vicious circle created by the treaty of Versailles....The economic solidarity of the world is more inexorable than the dictates of the Big Three at the peace conferences...With circumstances as such it could hardly be expected that the Babington-Smith Commission would anticipate the obvious follies into which the victorious countries of Europe drifted. In India the boom of companies in 1919-20 shows that a fall in prices was not only not expected, but a contrary process was confidently anticipated. Thus for the miscalculation nobody in 1919-20 could be held responsible."

The Minority Report.

So great was the importance attached to the minority report written by Sir D. Dalal, in the controversy which followed, that an examination of its main features and proposals becomes necessary. Naturally, our attention is first drawn to his general views on the currency system of India. He condemned the Gold Exchange standard on the ground that it leads to "the endless issue of token coins, much in excess of what is needed for internal exchange purposes."[1] The obvious reply is that, if a great country like India is in the position of having favourable balances and has not yet acquired the habit of foreign investment, its trade balances must be adjusted by an increase in its domestic currency. Indeed, Sir D. Dalal supplies, in fact, an answer to his own argument on the point. For, in another place, he asserts that the Indian market was not prepared to take outside

(1) Minority Report, paragraph 61

securities.[1] He there emphasises the fact that the currency has been inflated because the balance of trade was favourable and because the additions to the currency were the normal way of settling trade balances. The inference is clear and unmistakable, but it goes against its author's main contention.

It is curious also in a writer of such standing that he mixes up the conceptions of "ratio" and "standard,"[2] and the confusion is most marked when later he talks of a "standard ratio".[3] As a matter of fact, the standard in case of India was gold, and when sterling was divorced from gold the Currency Committee did its best to keep India to the gold standard by linking the Currency with gold. We further note that neither the Herschell nor the Fowler Committee professed to set up any "standard ratio", and expressly left room for changes in the ratio which they proposed. The Fowler Committee avowedly based the ratio of 1s. 4d., which they recommended, on the ground of its being the prevalent market rate and as such one that was adjusted to the circumstances of the day. The unmistakeable implication is that the right ratio to the fixed depends on the trade and currency conditions of the day, and any very important change in these dynamic factors has an important bearing upon the question of the determination of the ratio. The idea of there being any "natural" ratio was expressly disclaimed by the Fowler Committee, which asserted that "between the rate of to-day and that determined by the bullion value of the rupee there is none which can be described as natural or normal."[4] So also Prof. Gregory giving evidence before the Currency Commission of 1925-26 agreed that no exchange ratio had any particular claim to be called a "permanent" one, and that any ratio

(1) *Ib.*, paragraph 37.

(2) *Ib.*, paragraphs 17—21.

(3) *Ib.*, paragraph 21.

(4) Fowler Committee's Report, paragraph 68.

is permanent only so long as the leading factors maintaining it remain constant.[1]

Sir D. Dalal observes that "the authorities considered that there were only two alternatives open to them, either to raise the rate of exchange or to debase the silver coinage. But he goes on to suggest that quite a number of other courses were in fact open to them." Coming from him, these additional suggestions deserve careful consideration, and we note that the floating of public loans in India was one of his suggestions.[2] It would of course have been very desirable if India had the same habit of foreign investment as some other countries had. But Sir D. Dalal admits that India had not been prepared financially for absorbing her favourable trade balances in any other form than in precious metals."[3] Obviously, it would take a very long time to get India to let go her age-long practice of absorption of precious metals and to adopt the habit of foreign investments. He does not mention how or by whom there should be encouragement to India to use that method of settling trade balances. The sole suggestion which he makes is that during the war British Government loans could have been successfully floated in India on a very large scale. Seeing that it took stupendous efforts to float even the Indian war loans, one must be sceptical regarding the effects of the opening of British loans in India which would have certainly competed for popular favour with our own loans. Again, it is scarcely conceivable that the subscriptions to British loans, even if they had been floated in India, would have been on such a vast scale as to adjust our enormous favourable balances. On this topic we might quote the opinion of Sir S. Reed, himself a very friendly critic of the Minority Report. He observes that "when Sir Dadiba went on to suggest that the Government of India might have avoided this measure (i.e., the change of ratio) by

(1) Prof. Gregory, Q. 12,910.

(2) Minority Report, paragraphs 19—20 and 36—37.

(3) *Ib.*, paragraph 20.

large borrowings in India and encouraging investments abroad, he was on ground where no one in touch with Indian conditions can follow him."[1]

The second suggestion of Sir D. Dalal was that exports of silver should have been allowed from India "for the purpose of preventing the price of silver from rising." He adds that "in the presence of prohibitions on such export the high world price of silver can only be regarded as wholly artificial. India had the power, and it would have been profitable for her and to her interest to prevent the rise in the price of silver by sales of the metal. The mere fact of Indian sales would have broken the strength of the silver market.[2] On this topic, however, Sir D. Dalal has answered himself effectively. He showed with admirable lucidity that "a real practical difficulty in the way of removing the embargo on silver exports....was that silver exports would have increased the amount of the balance due to India."[3] But of course the whole difficulty was how to adjust these large balances of India and the course indicated by Sir D. Dalal would have admittedly made matters worse. However, he goes on to suggest further that in such circumstances it would not have been unreasonable for India to ask that her trade balances should be paid in gold."[4] But this is equivalent to arguing that, when the whole Empire was fighting for its very existence and all possible gold resources were wanted to raise loans in the United States of America and to buy munitions, India should have received her huge favourable balances in gold. To suggest this was of course to suggest an impossibility.

Equally unpromising was the other suggestion of Sir D. Dalal "to impose a duty on all exports at a rate sufficiently high to provide the means of meeting the additional cost of silver over the price at which silver could be bought

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(1) Banker's Magazine, September, 1926, p. 308.
(2) Minority Report, paragraphs 32 and 37—39.
(3) Minority Report, paragraph 37.
(4) *Ib.*, paragraph 37.

and coined without loss at the fixed ratio.'[1] The idea of putting on a general undiscriminating export tariff, and of thus depriving the country of the advantage of the foreign demand for its wares, only in order to have the theoretical satisfaction of maintaining a former ratio, is preposterous. It only illustrates the attitude of mind of the author of this report as regards the "natural" ratio. It should have been remembered that exchange ratios are fixed or stabilised for the benefits and convenience of trade. It is not the part of wisdom to sacrifice the development of and profits from trade in the interests of any ratio whatever.

Sir D. Dalal's main suggestion was in the direction of the use of debased silver coins. Without calling in the rupees in the hands of the public to be recoined he would issue a two-rupee coin containing a reduced quantity of silver.[2] For various reasons however this would have been a very dangerous course to adopt. In the first place the new debased rupees would have been suspected from their first appearance in the bazaars, and they would have gone to a discount,[3] while the old rupee would have been ultimately in danger of disappearing into hoards under the action of Gresham's Law. Then, again, as Sir D. Barbour pointed out, another result might have been to increase the number of rupees in circulation and so to raise prices. This, in its turn, would mean a further demand for rupees and incidentally for silver. Hence, the main, difficulty of the day would have remained unsolved, while the currency would be discredited and trade would be hampered.[4] Debasement of coinage had of course been employed in the Straits Settlements, but as Sir William Meyer observed this was not the right precedent for India to follow, since in the Straits Settlements "everybody took paper and nobody asked for silver."[5] Similarly, Sir L. Abrahams had argued that "if in India notes become as popular as they are in

(1) *Ib.*, paragraph 40.
(2) Minority Report, paragraph 41.
(3) Gubbay, Q. 434—435.
(4) Abrahams, Q. 921—924.
(5) Meyer, Q. 3,304.

some of the Eastern Colonies, and the chief place for silver coin were in the currency reserve, then I should say there would be no great objection to debasing the coins which are held in the currency reserves, which is what happened in the Straits Settlements.'"[1]

The best test of the value of the Minority Report is to examine the probable sequence of events in case it had been adopted. Suppose then, that the rate of exchange had been made to fall to 1s. 4d. (para. 12) and debased 2-rupee silver coins had been issued (para 41-2) as was proposed by Sir D. Dalal. In view of the fact that the exchange stood at 2s. 4d. (para 24), when these suggestions were made, it is obvious that very great inflation was necessary in order to lower the exchange to 1s. 4d. That would have necessitated the coinage of the debased 2-rupee coins on an unprecedented scale. This, in its turn, would have if any thing increased the demand for silver on the part of India, to its own detriment. But, further, as we have seen the war inflation which was already serious would have been aggravated by this unprecedented additional coinage. As it was the world prices fell in 1921 and led to the reversal of our balance of trade until the Rupee fell as low as 1s. 3⅝d. (sterling) in October 1921. But if we had added to the war-inflation another large measure of inflation on the lines suggested there could be no doubt that exchange would have gone down much lower. The only way of restoring the 1s. 4d. ratio would in that case have been to sell Reverse Councils in very large quantities and thus to contract the currency correspondingly. This course would also have led to a great dissipation of our gold and sterling resources. In fact we should have had to inflate in order to reach 1s. 4d. and then, when world prices came to fall as they did, we should have had to deflate heavily in order to maintain the rupee at 1s. 4d. We see therefore that had the Minority Report been acted upon, it would not have spared us the loss which ensued upon the sale of Reverse Council in 1920

(1) Abrahams, Q. 1,054.

but it would have added the confusion arising from the debased coinage which it would have taken many years to clear up.

Action taken upon the Report.

It was about February 1920 that the Government began to take action on the Report. It is to be noted that even then there was no reasonable fear of the balance of trade turning definitely against India or any tendency of the world prices to fall. It was only in June 1920 that the balance of trade began to move against India,[1] and it is further to be noted that prices went on rising in England until May, and in the United States of America up to June of that year. Indeed, in many other countries prices went on rising till July or even later. There was really nothing to cause any doubts as to the wisdom of the course recommended by the Committee; for between December 1919 and February 1920, the Indian Exchange rose from 2s. 4d. to 2s. 8d., while by the same month of February the price of silver had risen to 89½d.[2] The Committee had recommended that "in contrary to expectation a great and rapid fall in the world prices were to take place, it would be necessary to consider the problem afresh." But actually, when action came to be taken upon the Report, there were no signs of any fall of world prices, and the situation which faced the Government was the same as it presented itself to the Committee, only each characteristic feature of it stood out in bolder relief. However, by June 1920, (i.e., six months after the Committees Report was signed and some months after the Government began to take action on it) the tide turned with a vengeance. June was the critical month in more than one way; it was then that the balance of trade turned against India, and about that time the world prices began to fall. The price of silver too had fallen from 89½d. in February 1920 to 44d. by June. It was also noticed then that rupees began to return from circulation.

(1) Report of the Committee of Currency, 1920-21, p. 5

(2) *Ib.*, p. 10.

Thus about the same time there was a simultaneous disappearance of every factor on which the monetary policy of India had been based by the Committee. The weakening of the London—New York exchange was the last straw and it gave a bad send off to the new policy.

The most important adverse factor was the reversal of the favourable balances of trade. This was due, in the main of course, to the trade depression all over the world. But there were quite a number of subsidiary causes. We must note among them the political troubles of Europe and the collapse of the currencies of the European countries. These factors greatly lowered the capacity of Europe to purchase Indian products. Both in Great Britain and in the United States there was undertaken a stricter control of credit and a rise of discount rates. The monsoon of 1920 was of an unfavourable character. Above all, while exports fell, the flood of imports kept increasing and imports were at a maximum even so late as December. This flood of imports was due partly to the high exchange and partly to the fact that during the war and for sometime after, "India had been starved of her normal imports of manufactured goods". In many cases importers had anticipated and had acted on the supposition of a higher rate of exchange than 2s. It was no matter of surprise therefore that India had an adverse balance of trade of 77½ crores in 1920-21 and of about 21 crores in 1921-22.[1]

The fall in the price of silver was even more phenomenal than its rise. The rise had taken six years, but in the course of a single year—between February 1920 and February 1921—the price of bar silver per ounce fell from 89½d. to 31⅝d.[2] Such a situation was utterly unprecedented, and there were various factors leading up to this

(1) The phenomenon of an adverse balance was by no means peculiar to India in that year. Many other countries shared these conditions, especially those which had been exporting raw materials.

(2) Cf. Dr. Andre Failhas, "L'Argent—metal", (Paris—1922), pp. 180—187.

result. Demonetised silver coin from the Continent was being sold in large quantities; China, too had suddenly began to sell silver instead of buying it. A fluctuation of the New York cross rate was also influencing the price of silver.

The demand for Reverse Councils was greatly increased by the accumulated profits which had been retained in India for the years during and after the War, and which were awaiting the chance of remittance at favourable rates. In the Currency Reports of 1917-18 and 1918-19 it had been noted that homeward remittances had become considerably smaller than in the earlier years. A tendency had also been noted on the part of commercial houses to keep their balances in India. And all this pent up flood of homeward remittances was now ready to take advantage of the favourable rates offered by sales of Reverse Councils.

The policy of the sale of Reverse Councils has been vigorously attacked and deserves a careful examination. The matter will be taken up in its two main aspects; in the first place, we shall consider whether Reverse Council Bills should have been sold at all, and in the second place at what rate they should have been sold.

Strong criticism was directed against the sale of Reverse Council Bills before the balance of trade became adverse. But in this matter the Government had very little choice. The strictest injunctions had been laid down on the matter by the Chamberlain Commission and the Committee of 1919, and on no other point had commercial opinion been so insistent. The Chamberlain Commission had laid it down that the Government should definitely undertake to sell bills in India on London at a fixed rate, whenever they were asked to do so to the full extent of their resources.[1] Later still, complaints were made before the Currency Committee of 1919 of Government's hesitation about selling Reverse Councils when the war broke out. The critics were only satisfied when they

(1) Report of the Chamberlain Commission, paragraph 101 and p. 54.

were assured that "the present arrangement is such that if any one desires Reverse Councils and applies for them he would immediately get them."[1] It was not possible for the Government to disregard all these pledges and injunctions, and further, it was bound to give a fair trial to the recommendations of the Currency Committee of 1919.

As regards the rate at which the Reverse Councils were sold, in that matter too, there was practically no choice, for the policy of the Currency Committee having been accepted an effort had to be made to carry it out. To sell Reverse Councils at any other rates would have been to alter the ratio at the discretion of the Government. Nor were there any means of discriminating speculative from genuine demand for the bills. The very difficult position of the day is well summed up by Mr. Rushforth in an able tract on the subject. "While admitting the desirability of a just distribution of the Reverse Councils and the elimination of profits by speculators, it is necessary to remember that so long as the supply of sterling was inadequate no scheme of distribution could have obviated the inconvenience and uncertainty caused by the discrepancy between Government rates and market rates."[2] Nor did the procedure actually adopted in 1920 differ materially from that suggested by Sir L. Abrahams for adoption in case of the fall of exchange and in the price of silver. As we have seen how that great man had emphasised the principle that if exchange had to be lowered a great deal, the proper method was not to be precipitate, and to lower the rates suddenly, for by doing so we would create an artificial demand for reverse drafts from purchasers who would be afraid to be left behind. The proper course to be followed, according to him, would be to lower the exchange by two or more stages, and at each stage to test the potentialities and see whether the direction of trade had established itself again. The principle thus laid down had a fair trial; for from February to June 1920 the price of reverse drafts "was based on the theoretic 2s. gold

(1) Q. Q. 4,205—4,208.

(2) Rushforth, *Indian Exchange Problem*, pp. 10, 12, 20, 28.

parity for the rupee as measured by the sterling dollar exchange, a basis that involved offers at rate substantially in excess of 2s. sterling.'' From and after 24th June another position was tried, and the price of reverse drafts was based on 2s. sterling. The basic idea was to prevent undue stimulation of the demand for remittance and to see if stabilisation was possible at a lower rate. It was only in September that these efforts to maintain the exchange by sales of Reverse Councils was given up.

It remains to notice the lessons to be derived from our experience in the year 1919-1920. Our task is the easier in this respect because the lessons were partly anticipated by Sir L. Abrahams and Sir W. Meyer in 1919 and later on were admirably expounded and practised by Sir B. Blackett during the period stretching from 1923 to 1926. As we are going soon to consider and review the policy followed during this period we can only briefly summarise the main points here.

Circumstances seemed unusually favourable to stabilisation of exchange in 1920, and had they continued so, had the political settlement of Europe been effected on the soundest economic lines, and had world prices fallen gradually with increase of production, the stabilisation proposed in 1919 would have been successful at least for some years to come. But as it was, the bed-rock facts of war inflation and confusion of currencies, dislocated exchanges and disorganised production all over the world, asserted themselves with a startling abruptness and vigour. That striking phenomenon illustrated Sir Basil's dictum about the difficulty and danger of assuring fixity of exchange in a period of widely fluctuating world prices, and he might have added of exchanges too. The unusually favourable complex of circumstances having vanished, the true dimensions of the great task preliminary to stabilisation in India became discernible. It became then apparent that we had not only to wait until the currencies and exchanges of the great commercial and industrial countries had returned to

something like the normal, but that we had to undo the work of war inflation at home at least in some measure, in spite of the special difficulties of contraction in India. As long as deflation is not resorted to in an adequate measure, and the price parities are not favourable to maintenance of exchange, the task expected from sales of reverse councils is too heavy even for that mechanism, as was seen in 1920. For, it must not be forgotten that exchange stabilisation is not a mere matter of adopting certain measures regarding the exchanges, but must be based on a comprehensive economic policy. In particular, a suitable price policy must precede a successful exchange policy and the two must be in full harmony. It is to the credit of the Committee of 1919 that it saw the importance of the problem of prices and strove to lower them directly by sales of gold and indirectly by raising the exchange. But a drastic or immediate deflation was out of question then in the midst of a boom (which for aught any one knew might only be beginning) and while Indian prices were lower than world prices. The time came however when the problem of the reduction of war inflation had to be taken in hand, and it is to this stage of preparation for stabilisation that we now turn—noting first, however, that the difficulties of this stage were largely increased by the succession of budgetary deficits.

The period of "mobile" exchange.

The exchange and monetary policy of Government during the period 1921 to 1925 might be described, in its earlier phase, as an effort to prevent exchange from falling below even 1s. 4d. sterling, and, in its later phase, as that of securing some thing like adequate deflation and of preparation of resources and survey of ground for an ultimate stabilisation, whenever it was felt to be due. With her exchange slowly rising through progressive improvement of the trade position, with her resources in the reserves properly conserved, with her price levels stable in a measure unknown to other countries, and without tying her currency

to that of any other country India was awaiting the favourable opportunity for stabilising her exchange which the improvement of world conditions was to afford her at no very distant date. However, there were proposals from many quarters as early as 1921-22 to stabilise exchange at 1s. 4d. It was argued that the resources of the Gold Standard Reserve were meant to support exchange and to stabilise it. Sir M. Hailey had no difficulty in showing that the resources could advisedly be used for such a purpose only when our balances of trade became normal. Then would be the time for making a full use of our sterling reserves, while any premature effort at stabilising the exchange would have led only to a dissipation of those resources. It was indeed fortunate that no attempt to stabilise was made at this period, since it would have involved India in the heavy fall of price, which England and other countries witnessed at this period. As Mr. Keynes put it, under those circumstances India would presumably have felt the full fury of the price fluctuation in Great Britain. "Stability in the internal price level is so superlatively desirable in such a country as India, that the fact of her having got through the recent cycle with so small a fluctuation of internal prices is a great deal to be set against the inconvenience to merchants engaged in foreign trade from the fluctuations in exchange."

It was alleged at the time in favour of the policy of early stabilisation that unless the exchange was fixed at the rate of 1s. 4d. its tendency would be to fall still lower. It was in fact assumed that the world was entering on a prolonged period of low prices and that unless an effort was made to fix the ratio at 1s. 4d. the Indian exchange was going to fall lower and lower. The course of events has not fulfilled these prophecies. With some reduction of the burden of inflation and with the advent of better trade situation, the Indian Exchange began to rise steadily and would have if left to itself, gone far above 1s. 6d.

Then there are those who argue that the Rupee could have been stabilised at 1s. 4d. sterling in the beginning of 1923. They thus admit by implication the absolute necessity of the major part of the deflation which was carried on in the three earlier years. So strong had been the deflation in England and United States of America in the years 1920 and 1921 that stabilisation of the exchange was not possible in India without an effort to do away with some part at least of the war inflation. It is inconsistent to talk of "undue contraction of currency" and yet to propose to retain the gains of such contraction. It is admitted further that the maintenance of the ratio at 1s. 4d., if then fixed, would have meant trouble and sacrifice to India implying further deflation among other things. Finally, after the experience which the Government had had of repeated and violent exchange fluctuations from 1917 to 1923, it could not possibly be sure that because the rupee had reached 1s. 4d., in January 1923 it was destined to stay there for any considerable time. There were too many uncertain factors in the situation of the time, the rising trade balance had not asserted itself nor had financial equilibrium been secured. Whatever later critics might say in the light of further events, the commercial opinion of the country was quite against stabilisation at the time. Just at the time when the rupee reached 1s. 4d. the spokesman of the Karachi Chamber, Sir Montague Webb thus expressed the general view. "With the currency systems and prices of Continental Europe entirely out of control, who can say what will happen? If India continues to experience difficulty in selling overseas sufficient of her surplus products not only to provide the wherewithal to make her customary purchases from overseas but also to meet her sterling liabilities, say, thirty millions per annum, what will happen to the sterling value of the rupee? Why the Government of India have not yet achieved that *sine qua non* of rupee stability—a budget wherein expenditure is restricted to the amount of revenue collected. With all these difficulties and uncertainties before us—and I would remind you that

the general situation, especially in Europe, baffles the most experienced economists, currency experts, bankers and statesmen--can we with any assurance or certainty say to Government that 2s. or 1s. 8d. or 1s. 6d. or even 1s. 4d. is the correct figure at which the rupee should now be linked to the sovereign? There can be no doubt about the reply. The wisest course in the circumstances, I submit, is not to attempt to dogmatise as to the correct level of our foreign exchanges, but to carry on with the utmost caution, and to adjust our position from day to day, week to week, and month to month, as the needs of the moment demand. For these reasons, the Karachi Chamber of Commerce unhesitatingly supports the view of the Bengal Chamber that no alteration of the nominal ratio of the rupee to the sovereign will be of any advantage to India until world conditions have become more stable, and until the internal finances of the country have been put on a sound basis.''

The budgetary equilibrium which was thus admittedly an essential pre-requisite of the stabilisation of the rupee was not reached until the year 1923-24 when a start was made with a surplus of two crores. As Sir B. Blackett put it, it was ''the Budget of 1924-25 which signalised our definite escape from the era of deficits''.

Indeed, as late as the year 1926 some eminent economic authorities were of opinion that the time was not ripe for the stabilisation of the rupee. The stabilisation of our currency and exchange was in an important sense an international problem, and one of the leading considerations in determining whether the time for stabilisation had arrived was the possibility of a reasonable estimate of the future course of world prices and monetary policies. Naturally, the maintainability of any ratio to be fixed for India depended to a very great extent on the then uncertain course of prices and monetary developments abroad. In the quinquennium 1920-1925 great monetary developments have taken place in various countries and economic opinion on important currency matters has been in a state of flux—

there being on one hand a tendency to go back to pre-war arrangements, and on the other hand strong suggestions to make radical departures from them. The price and discount policies of the leading countries have been discussed, experimented upon, and gradually and in great measure settled. Nor, with the best intentions, has it been possible to prevent considerable price fluctuations. Prices in England went through a great fall through the years 1920 and 1921. There was another but much smaller rise of prices in 1922-23 and a later fall in 1925.

American prices too have gone through great fluctuations between the years 1920 and 1925. In that country there were noted during that period no less than three periods of rising prices—1920, 1922-23, and 1924-25; there were also two periods of falling prices corresponding to the years 1920-21 and 1923-24.[1] Many other countries had their full share of what Prof. Edie has well termed the "outstanding phases of this period of price turbulance". He added that "this shifting of relations is not confined to money and prices alone. It extends to the outside factors, such as unbalanced budgets, foreign exchanges, industrial and trade conditions and psychological changes reflected in optimism and pessimism."

Such uncertainty of prices and of price-policies in the leading countries added greatly to the risk of maintaining any ratio that had been fixed at that time. Had the gold prices fallen materially after India had fixed such a ratio, we should have had to undergo a further and drastic deflation with all its inconveniences. On the other hand, there were powerful partisans of inflation both in England and in the United States at the time. The danger was the greater from any inflationist success in the latter country, with its vast accumulated gold resources and its position as the great creditor country. Looking to the banking situa-

(1) Cf. Prof. L. Edie's *"Post-war fluctuations in wholesale commodity prices"* in American Economic Review, March 1928. (Supplement).

tion in the United States, Bonnet well remarks that with the bank reserves climbing up at some periods as high as over 80 per cent at times, the maintenance, on the whole, of a wise and moderate credit and price policy on the part of the Federal Reserve Banks has been a marvellous and wholly unexpected phenomenon.[1] This is to be attributed to the new spirit which has actuated the Federal Reserve Board and the new task which it has set before itself. That task has been to keep the purchasing power of money stable, an aim that was almost unknown to the pre-war banking theory or practice, generally speaking. The method adopted has been not to avoid all increments of credit but to so regulate it as to keep prices steady. The method was, of course, not learnt in a day, and a great mistake was made at the start in 1919-20 in the great expansion of Reserve credit. But as time went on, the new ideals and methods were adopted not only in America but later in England also. However, at the time of which we are speaking—in the years which followed the Indian Currency experiment of 1920—there could be no assurance or even glimpse of such a new and wise price policy to be followed by America. Nor, further could it have been anticipated how, under the guidance of the late Governor Strong, America would assist in the monetary reconstruction of a number of European countries, and thus facilitate the task of monetary reform generally. Before that development the only hope of the stabilisation of prices and currencies seemed to be in an international co-operation guided by international conferences. We know that Dr. Vissering and other economic authorities worked since 1920 in that direction.[2] But we also know how frequently futile and generally dilatory such conferences can be. Fortunately however events took a new and unexpectedly favourable turn about the year 1924-25.

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(1) Bonnet, *op. cit.*, p. 58.

(2) Cf. Vissering, *International Economic and Financial Problems.*

Political factors conspired with Economic circumstances to perplex the problem of exchange stabilisation and to delay its solution. We might borrow a brief but adequate description of the situation from a well-known American authority on banking, Dr. W. R. Burgess: "At the end of 1923 and moving into 1924, we were in a period of some business depression. The skies were a bit dark in this country and the world over; there was a good deal of disturbance because England was not yet back on a gold basis, and most of the other Countries of the world were yet in uncertainty. The Dawes plan had not yet been concluded although the experts were working on it; agricultural prices were on the tobbogan." He might have added that the French had entered the Rehr and that this act of aggression had further darkened the political situation of Europe.

Speaking before the Associated Chambers at the end of 1923, Sir B. Blackett pointed out that had we then stabilised the rupee at sixteen pence (sterling) we should by doing so "have surrendered our freedom of action in a matter which vitally concerns us. In effect, our currency policy would have been liable to be dictated to us from abroad. For good or for evil we should have been bound to conform to the movements of sterling at a time when even sterling is liable to fluctuations that may well be very considerable." We should also have introduced considerable and abrupt changes in the Indian price level. We should have began by inflating currency in order to bring down exchange from 1s. 5d., and then "the Government of India might have to deflate again and to expend their foreign reserves in an attempt to force down internal prices *pari pasu* with a downward movement of prices in England as compared with the United States."

On the other hand he went on to say that if we had stabilised at 1s. 4d. *gold*, we would have been "involved in fluctuating relations with sterling in which at least nine-tenths of our transactions in foreign currencies are express-

ed. We should have paid for our fixed gold value of the rupee by having to put up with sterling rates that rose to 18·09 pence on November 17th and fell as low as 16·52d., a range of more than a penny half-penny.''

Our discussion has shown that there were many circumstances which made the stabilisation of exchange, even in 1924, inadvisable. India was well advised to hold her hand in a period of unprecedented economic instability when the future of price levels and international trade, of monetary policies and standards was most uncertain. She had made sure not only of price stability but of a reasonable exchange stability by 1924. She also retained her liberty to conform only so far as suited her own interests to the exchange and price movements of other countries. Sir Basil Blackett well described such a policy in his felicitous economic phraseology. ''If I may state the case in the form of a paradox, I will say that it is precisely the mobility of prices, exchange and currency which makes it possible to maintain something approaching to an all round equilibrium. So long as the different forces can be played off to a certain extent against one another they can be made to produce a fairly constant resultant; but if you once fix any one of them you will find that in the absence of a real approach to world stability you have increased instead of diminishing the oscillations of the reminder.'' That was a terse and suggestive analysis of the situation worthy of that great financer and economist. It meant also a revival of that wise policy which Sir W. Meyer and Sir L. Abrahams had recommended to the Currency Committee of 1919.

LECTURE VI.

MONETARY RECONSTRUCTION IN INDIA (1925-1926).

Need for Monetary Reconstruction.

The pre-war monetary system of India stood the strain of the Great War as well as any other standard; but when to the troubles directly caused by the war was added the phenomenal rise in the price of silver, it was thrown out of gear. As has been well put, "it was essentially the rise in the price of silver which upset the Indian Currency system". Since then, "the rupee had been a managed currency bearing no fixed relation to gold". When the time came for the task of stabilisation to be taken in hand, the possible lines of improvement in the system, as worked in India before the war, stood out prominently, in the light of experience. That experience had drawn attention to the dependence of the system on the price of silver, and it was the first requisite of a monetary reconstruction to free the country's currency from the threat implied in the possible rise in the price of silver. In the second place, the war had also brought home the dangers of a possible divorce between the sterling and gold. This consideration emphasises the superiority of the system of gold exports for supporting exchange over that of sale of sterling drafts. In the third place there was, in the absence of statutory regulation, no theoretically perfect means of securing a fully adequate contraction of the circulation when the exchanges were adverse. But further, the pre-war system was wanting in the sort of mechanism which would act simultaneously on prices both at home and abroad, and bring about their adjustment in periods of favourable or unfavourable balances. To take an example, when the balances were unfavourable a country on a thoroughly efficient gold

standard should be able to export gold, thus lowering prices at home and raising them abroad. On the other hand when the balances was favourable, there should be an import of gold leading to a rise of prices at home and to a fall of prices abroad. Hence a proper gold standard should be based on the principle of timely efflux and influx of gold, with consequent effect on prices both ways.

But any thorough-going reform of the system required the formation of a central bank which could serve as the pivot of currency operations. Almost all the defects of the pre-war system were due to the absence of such an institution which should combine the control of credit and currency and introduce unity of policy in both these directions. The necessity was obvious of giving India *pari passu* with a currency system of the most advanced character, a controlling authority competent to deal with the task of management of currency affairs. Any scheme of monetary construction had also to include the reorganisation of the Paper currency system of India. That system was also suffering from the combined results of the earlier defects of organisation and the effects of war. The old fixed fiduciary system was making the note issue unduly rigid; and though it had been modified of late and the fiduciary issue was made proportional to the whole, still it was necessary to renounce the system which had caused so much inelasticity and to introduce one which was fully suited to the circumstances of the country. The system of emergency issues too had to be improved and the importance and superiority of commercial bills as instruments of the desired elasticity had to be fully utilised. Undesirable excrescences like "created securities" were to be lopped off and their extinction had to be expedited.

The Gold Bullion Standard-its antecedents and distinguishing features.

Passing to the actual plan of monetary reconstruction, laid down by the Commission, we shall first note the Gold

Bullion Standard recommended by the Committee and examine its character. It would assist this exposition to glance at the changes in the practice of and ideas relating to the Gold Standard. The "Gold Standard" as restored in so many countries since the war is different from the pre-war gold currency system, and its distinguishing feature is the obligation imposed on the currency authority "to buy and sell gold bullion without restriction at fixed prices."[1] A great change has come about in the practice of the gold standard since the great war. Even before the war, the use of gold coin was becoming less important or significant, and it is now generally admitted that the use of gold coins is in no way essential to the gold standard. In several countries efforts made to introduce gold circulation have failed owing to a want of popular preference for such a currency. Such had been the case in Holland and Switzerland. In some great countries the people have become accustomed to paper currency and there is no desire for gold coinage. Even apart from the question of inclination, it is obvious that a restoration of gold currency on the pre-war system would require a very great redistribution of the world's gold stock and, indeed, a great increase in the aggregate stock of gold, while what is actually required is an economy in the use of gold.[2] In this matter theory has come to support and justify the prevailing practice, and eminent theorists argue that "gold coin is in fact, an imperfect application of the Gold Standard."[3] As regards the question of definition, it would be easy to find and quote older definitions of the gold standard which would disqualify every existing system and deny the right of any country in the world to the possession of a gold standard.[4] But one would prefer to look to the description of a gold standard from an authority like Governor Strong who had worked gold standard in America for

(1) Hawtrey. *The Gold Standard*, p. 110.
(2) Nogaro, *op. cit.* p. 220.
(3) Hawtrey, *The Gold Standard*, p. 95.
(4) Robertson, *Money*, pp. 67—68.

many years and who had helped to restore in it in a number of countries. "The essential elements of a full gold standard are complete convertibility of the note issue into gold, an absolutely free gold market, an unfettered foreign exchange market, and a banking system which effectively assimilates gold imports and regulates the consequences of gold exports."[1] Bearing in mind such descriptions of the gold standard as also the more modern definitions of the same, we shall have no hesitation in recognising the true character and merits of the standard recommended by the Currency Commission for India.

Ricardo's Ingot plan.

The system of Gold Bullion Standard as proposed for India by the Commission and as adopted in England can be traced back ultimately to the famous Ingot Plan of Ricardo. That plan was first sketched in 1811 and then made more specific in 1816 in his tract called the "Economical and Secure Currency." Later, still it was developed in the evidence before the Secret Committee of 1819. In an article in the Economic Journal for September 1923, which will become the *locus classicus* for the study of the development of the Ingot Plan, Prof. James Bonar has traced the history of the plan until its adoption temporarily in 1819. The plan was given most succinctly in a memorandum before the Secret Committee.

1. That the Bank should be subjected to the delivery of uncoined gold or silver at the mint standard and price in exchange for their notes, instead of delivery of coin.

2. That the Bank should also be obliged to give their paper in exchange for standard gold or silver, at fixed prices, taken somewhat below the mint price.

3. That the quantity of gold or silver so demanded in exchange for paper at the Bank, should be limited, not to go below a fixed amount.

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(1) Governor Strong's evidence before the Royal Commission on Indian Currency, Q. 15,227.

Ricardo claimed as one of the chief merits of his plan that it would make gold coin unnecessary. As he observed, "the object of my plan would be most completely effected by there being no gold coin in circulation"; he argued to the effect that "to buy gold unnecessarily is to waste the goods that buy it; we might as well throw it into the sea"[1] The gold would be "a dead stock without advantage or profit."

The plan was adopted in England for a time; and what led to its abandonment has been the object of much speculation. Mr. Bonar suggests that the Bank disliked the additional responsibility placed on them of buying and selling gold in the interests of national currency. He also remarks that perhaps the limit of 60 ounces fixed for buying and selling gold was too low, and that the much higher limit of 500 or even 1000 ounces suggested by MacCulloch would have suited the bullion market and the industrial demand of gold better. But a great deal of the responsibility for the turning down of the plan must lie with politicians like Cobbett, who condemned the plan without understanding it. Much was also due to the old popular fondness for gold currency. It would be difficult to exaggerate the influence of Ricardo's plan on the history and evolution of Indian Currency. It is interesting to recall that as far back as 1879 Robert Lowe, afterwards Lord Sherbrooke, had made an attempt to adapt Ricardo's proposals to the case of India. He thus anticipated the Royal Commission on that important topic by about half a century. By a singular coincidence, in the same year, Mr. Lindsay had also brought out a tract in which Ricardo's plan was advocated for adaptation as the solution of the currency difficulties of India. But while the gold exchange standard plan advocated by Lindsay was "implicit" in Ricardo's project, Lord Sherbrooke's scheme was an even closer adoption of the Ricardian model, and proposed to maintain Indian currency

(1) Fortnightly Review, July 1879. Probyn *Indian Coinage and Currency*, p. 15.

at par with gold by requiring notes to be redeemed in gold bullion and to be issued in exchange for the same.

We find that Lord Sherbrooke not only advocated, like the Commission, the Gold Bullion Standard, but in the same spirit he envisaged the ultimate dethronement of silver. Similarly, too, he compares the merits of the Gold Bullion Standard with those of gold currency to the advantage of the former. In fact it is a case of remarkably close coincidence, and the anticipation of the Report of the Commission of 1925-6 is so exact that a couple of extracts from the article by Lord Sherbrooke will be found interesting. "People talk of gold flowing into a country till they seem to have convinced themselves that this is a gratuitous process, and to have banished from their mind the undoubted fact that for all the gold which enters the country an equivalent value must be given. The difference between the two uses which may be made of gold, is the difference between reserving a comparatively small sum in bullion to correct by the liberty of purchase any tendency of a paper currency to expansion or contraction, and the manufacturing, paying for and perpetually renewing the whole metallic circulation of the State." It might be remarked that the contrast between the Gold Currency system and the Gold Bullion Standard could not have been better stated, nor the fallacy of the usual facile projects for gold currency better exposed. In the next extract the author of the proposal summarised the nature and aim of the Gold Bullion Standard. He observes that "when a gold standard is once established by means of notes convertible into gold when tendered in sufficient quantities, it will be easy to demonetise the rupee by limiting the privilege as a legal tender to small sums, as is the case with our own silver currency."

Merits of the Gold Bullion Standard.

The Gold Bullion Standard marks a considerable improvement on the pre-war monetary system of India and, is free from many drawbacks which experience had detected in

the latter. Thus, the new system has nothing to fear from the danger caused by any *rise in the price of silver* beyond the melting point of the rupee. That fear had always been like the sword of Damocles hanging over the pre-war system; and indeed it was this rise in price of silver which at last threw it our of gear. This old danger is now guarded against *by a chain of important proposals,* the first of which is that in future our paper currency should cease to be convertible into silver coin. This in its turn will render unnecessary the keeping of large stocks of silver in the currency reserve; and there is the further corollary that the coinage of silver should be stopped at least for a long time to come.[1]

But, further, the Gold Bullion Standard gives us that much longed for and sought for feature—a conspicuously visible link between the currency and gold. We had always been told that in the absence of such a link there was a growing distrust of the rupee, with its corollary—the hoarding of gold. We have now the certainty of avoiding these objections, since the currency authority will have to provide gold bullion by weight and not merely for export but for any purpose whatever.[2] "The statutory obligation to buy and sell gold for rupees without limit at a prescribed parity for the first time in the history of the rupee will base it on gold firmly and in a manner that is conspicuously visible." The question of the adequate *convertibility* for the local currency had been debated almost from the beginning of Gold Exchange Standard in India. It was urged repeatedly that the want of absolute convertibility was responsible for a redundancy of currency and a resultant rise of prices. There were, it was said all shades of convertibility and only the fullest and ideally perfect convertibility will do for a good monetary standard. We have now at last a plan which provides for the most effective convertibility—converti-

(1) Report of the Royal Currency Commission, paragraph 69—70.

(2) *Ib.*, paragraphs 60—61.

bility into gold bullion; and the gold bullion, be it noted, is provided not merely for export as was proposed in same schemes of reform, but for any purpose whatever. As the Report adds, "the obligation is to convert the currency not merely into foreign exchange, but into metallic gold, and it is an obligation that is not as formerly conditional and circumscribed but absolute and unlimited."

The old controversy about the statutory regulation of the Gold Standard Reserve has at last been laid at rest by the new system. As has been admitted freely by a high authority on the pre-war system, "there was a fundamental restriction on our undertaking to support exchange. It was not an undertaking continuously to maintain exchange. It may be described rather, as an undertaking which bound us as long as we had resources, to use those resources in *restoring* exchange if exchanges had fallen outside the gold point. The pre-war undertaking might even in ordinary circumstances have not acted efficiently."[1] As the same authority added later, there was an element of personal judgment in the system and hence he would readily recognise "the advance in an unqualified undertaking to sell gold for export."[2]

It is obvious further, that the prevalence of *hoarding* must affect adversely the working of either the gold currency system or the pre-war monetary system. For the ebb and flow of sovereigns and rupees to or from the hoards would under both these systems make arbitrary additions to or reductions from the currency in circulation. These arbitrary changes due to the existence of hoards might on occasion stultify the effects of the currency authorities to contract (or it might be to expand) currency. It might be added, however, that the Gold Bullion Standard is the system which would be least affected by the existence of hoards; because, on the one hand, under it, the sovereign

(1) Sir J. Brunyate, Q. 11,322.

(2) Sir J. Brunyate in the *Journal of Royal Society of Arts* 3rd December, 1926 p. 75.

will be deprived of the legal tender quality, and, on the other hand, the recommendation as to the stopping coinage of silver rupees for a long time to come will ensure the automatic reduction of rupees in the hoards. These hoards will thus be deprived of their power to influence adversely the working of currency and prices, since their capacity of acting on the volume of circulation by injecting sovereigns and rupees into it will be gone.

Finally, the obligation to sell and purchase gold which is imposed on the currency authority by the scheme of the Gold Bullion Standard ensures that *double action on prices* both at home and abroad which was denied to the older system, inasmuch as possessed only the resource of selling exchange on foreign countries Under the new standard the export or import of gold from India will act not only on the Indian price level but on the foreign prices, and the adjustment and maintenance of the international price level will become easier.[1]

The identity of the Gold Bullion Standard with the post-war monetary systems prevailing in the most advanced countries is obvious. Thus, in the United Kingdom too the Gold Standard Act of 1925, adopted the Ingot Plan of Ricardo, and the system is maintained by the obligation placed on the Bank of England to buy and sell gold by weight.[2] In other countries too, the restoration of gold standard has meant, as we have seen, the adoption of a system by which an obligation has been imposed on the currency authority to buy and sell gold bullion without restriction at fixed prices. Since in these countries there is no fear of any recrudescence of gold currency, it might be taken that India also having attained the most perfect form of monetary standard as yet devised and sharing it with the advanced countries, will desire to keep to it. To quote Sir Stanley Reed "when confidence in the gold bullion standard is firmly established, India, with a free voice

(1) Prof C. J. Hamilton's evidence, Q. 10,672—10,685.

(2) Economic Journal, 1925, pp. 312—313,

in deciding, will find that a gold currency is not worth the expense and risk involved, and is not necessary." He also went on to add that "the gold bullion standard satisfies all the country's real needs."[1]

The Gold Currency proposal.

The main alternative to the adoption of the Gold Bullion Standard was the introduction of a gold currency; and coming to consider that topic, we note in the first place the significant fact that the latter idea was rejected unanimously by the Commission. We shall advert in a moment to the reasons why it was rejected. But the discussion of the gold currency idea before as well as by the Commission was in itself a most important contribution to the general economic study of the topic of Gold Currency. A scheme for the introduction of gold currency was worked out, by men of high ability and unique experience, in all its details, and was freely and fully threshed out not only by experts in India by many of the most eminent currency experts of the world. The problem was carefully formulated and studied in all its aspects as it never was before. Every item in the cost of introducing such a currency, and every difficulty in the way of its adoption was fully considered, and the potentialities of that currency system were studied as they never were before. This study was in fact itself a contribution to the subject of monetary practice; and since no other country is likely again to introduce a gold currency, that study will probably remain a unique one. In view of the great part played by projects for a gold currency in the monetary history of India, we might glance at the main features of the most promising and perfect scheme of the sort that was ever placed before the Indian public.

One very important respect in which the Finance Department's scheme for a gold currency differs from other proposals with the same object is in a careful calculation of

(1) Banker's Magazine, September, 1926, p. 306.

the cost necessarily involved and in the provision of resources with which to meet the cost. The main defects of the older schemes with the same object, which we have dealt with before, and even of similar contemporary proposals, are that they are rather vague, that they ignore essential elements of the costs involved and further that they fail to provide adequate resources to meet the bill. The authors of these alternative schemes are so anxious to show that a gold currency can be introduced in India with a trifling cost or even without any expense at all that they leave their projects very incomplete and make no provision for the convertibility of the present note issue and of rupees into gold. A necessary corollary of the adoption of each schemes would be the confusion caused by the existence of two kinds of note issue, only one of which is convertible into gold. They further assume, in their quest of cheapness, that India will not require anything like an adequate number of gold coins, and they neglect to provide for any saturation of the non-monetary demand for gold and for any substitution of gold for silver in the hoards. And yet they call the system which they have thus projected a "full" and "effective" gold standard. If, indeed gold coin is going to form so small a portion of the proposed currency system, how is it going to fulfill the important functions which are claimed for it? Unless there are very substantial amounts of gold currency in circulation, how is the anticipated psychological revolution to be brought about, which, it is said, will cause the hoarding habit to disappear? How is a coin which is not in substantial circulation to inspire that general confidence in the currency system which has been claimed for it, or to have the full educative effects in forming correct notions regarding currency matters? One can quite agree with the view that "once a thing becomes common people do not want to hoard it." Hence if a gold currency is to weaken the hoarding habit, gold coin must be made freely and commonly available to the people for a sufficient length of time.

Far different in all these respects was the policy regarding the introduction of the gold currency adumbrated by the Finance Department. To start with, the ideal proposed was clearer and more scientific. Gold circulation was not to be regarded as the ultimate or final ideal but a transitional stage towards the ideal gold standard.[1] Consequently, it was necessary to reach the gold currency within a fairly short time, and the task of this stage was to stimulate the investing and banking habits and to get rid of the hoarding tendency. The cost, too, of introducing a gold currency was calculated with great care. India would require sufficient resource to convert approximately 100 crores of silver rupees in hoards into gold, as well as about 10 crores of the rupees in circulation.[2] Another item in the cost would be the loss on the rupees which would have to be sold. The country would also lose by the depreciation of the value of the silver held by individuals in it. As Mr. Keynes has pointed out "silver is very greatly an Indian interest," and is not to be treated as only a foreign interest. For these two latter items, however, no exact or even approximate figures could be arrived at. The additional gold resources required by the operation would amount to about 103 million sterling. These fresh gold resources, added to those accumulated under the Gold Exchange Standard system, were judged sufficient to saturate the country as regards non-monetary demand for gold and to give the country sufficient gold coin required for currency purposes.

The scheme, however, failed to recommend itself to the Commission for several reasons. The estimates of the gold demand though carefully gone through were avowedly uncertain, and probably the cost as well as the resources required would have proved to be greater in actual experience. But the main difficulty, and the one which proved insuperable, was the impossibility of securing assistance in

(1) Sir Basil Blackett's evidence, Q. 10,206 and 10,276.

(2) Sir Basil Blackett's evidence, Q. 498; 510; 10,222—10,233; Q. 494 and 10,224.

the matter of the resources required from America or England. America was not likely to lend her assistance to us in this matter, partly on account of its silver interests, but mainly because while willing to spare her gold for purposes of reconstruction and stabilisation of currencies, she was averse to lending it for the inauguration of a gold currency and would not grant the necessary credits.[1]

In the light of events one can see that the Commission if anything understated the danger to the world prices from a considerable diversion of gold resources for providing a gold currency in a country. The Commission could not of course foresee the fall in the price index numbers of every country which has taken place since the year 1925-26. Nor could it have foreseen how slow and difficult would be the process of any tangible increase in the production of gold. But we can now see in the light of these later developments how very justifiable was the insistence of eminent economic authorities on the utmost economy of gold and on the co-operation of central banks for the purpose. Under these circumstances strong objections have been taken to the recent process of acquisition of gold by the European banks for strengthening their reserves by the substitution of gold for foreign exchange. Recent studies relating to the present day gold production and its bearing on the currency problem have drawn attention in the first place to the increased demand for gold due to the stabilisation of currencies. "On account of the higher level of prices, the structure to be supported by the gold basis is greater than before the war, and it is doubtful whether the present rate of gold production is keeping pace with world development, while the total of the gold output tends downwards. In the altering circumstances the future is more likely to be concerned with appreciation of gold, than its depreciation, and the problem of greater stability of value is one for all gold standard countries. A great deal will have been accomplished if, by co-operation, the short-time fluctuations in

(1) Evidence of Governor Strong, 15,103 and 15,322.

the value of gold can be levelled out and the long time movements made so slow and smooth as to be almost innocuous to production and trade." Such is the position as regards gold production as interpreted by experts in gold mining and currency matters. Under such conditions one can understand the reluctance to divert at least £ 103 millions in gold for endowing a gold currency—a system which no other country possesses and which was condemned by not a few Indian economists before the Currency Commission. Nor should it be forgotten that the £103 millions worth of gold going to India for the purpose would be over and above the large imports of gold on other accounts; and that in the last four years these latter imports have amounted to no less than Rs. 217 crores. There can be no question that demands for gold on such scale are bound to exaggerate the prevailing tendency towards the fall of prices and must precipitate that scramble for gold of which the signs are already apparent.

Then, again, as to the question whether India has a strong interest in the rise and fall of world prices, an appeal might be made to fairly recent economic history. The prosperity of India during the first decade of the present century, the vast expansion of its trade and the stabilisation of its exchange ratio were certainly not unconnected with the rise of world prices during that period. On the other hand India has had its full share of the troubles associated with the great fall of world prices after the year 1920 as well as during the last quarter of the nineteenth century. These are the considerations which supply an answer to the question whether the attainment of a gold currency on the part of India is likely to bring about a fall of world prices and whether such a fall is necessarily prejudicial to Indian interests. It is of course true that if India demands gold from her trade debtors she asks for no more than what is her due. Only, it is not a question of enforcing an absolute legal right at any cost but of the expediency of enforcing it against her own as well as against general interests.

There were other suggestions for improving the Indian currency system before the Commission, apart from those for a gold currency. Governor Strong of the Federal Reserve Board made various suggestions for a "broadening out" of the Gold Exchange Standard. The suggested leading features of this process consisted of leaving to the rupee the full legal tender quality while suspending its further coinage and of ceasing to operate the standard through a single market.[1] We have already noticed the alternative proposals of Sir B. Blackett as regards the pre-war monetary system of India into an international exchange standard.[2] The main alternations proposed by him with this object consisted of the fixation by statute of the import and export gold points, a statutory provision as regards the reserves and the imposition on the currency authority of the obligation to buy and sell gold. When we compare these proposals with the scheme of the Commission for the establishment of a Gold Bullion Standard, we shall find that the Commission's scheme has incorporated almost all the suggestions made in this direction either by Sir Basil Blackett or by Governor Strong. What is further to be emphasised is that both these authorities laid down as the necessary condition of any improvement of the currency system of India the formation of a central bank, which by laying down a wise discount policy and by properly regulating the expansion and contraction of currency, would ensure the proper working of the improved standard. The scheme of the Commission, it is submitted not only incorporated all the reforms indicated above but several others and also paid special attention to the formation of the proposed Central Bank.

The Currency authority—The Reserve Bank.

We have noted the improvement of monetary practice and theory in their various aspects during the last few decades; but perhaps in no direction has such development

(1) Dr. Sprague, Q. 15,311; 15,327.

(2) Sir Basil Blackett's Evidence, Q. 9,989—10,045.

been more marked than in the sphere of the development of the functions of the central bank, and its growing importance in the monetary system of a country. The very phraseology now used in speaking about the work of such banks bears eloquent testimony to their dominating position in the matter of the regulation and working of monetary systems. Older writers on banking did not speak of the central bank as "the sole source of legal tender money." They did not describe it as "the controller of the volume of money" and as the "adjusting mechanism" in the monetary system. It is now regarded as the *managing authority*, not only as regards credit but currency, and it is now expected to serve a very important part in securing the stability of prices. We might remember that about fifty years ago, when the Government of India sent up a monetary scheme for consideration, a committee of experts which included Sir R. Giffen rejected it summarily, merely because it proposed a "managed" currency. Those were the days when Economic Liberalism was all powerful, and the notions of the "orthodox" school of Economics in currency matters were still accepted, while automaticity was the pass word for all currency system. There was then abundant reason for this state of opinion, since in those days no special financial organ had been yet fully evolved for the function of currency management. But, since those days, "the older ideal of automaticity has receded into the back ground", while we recognise that all currencies—even the gold currency system—must be managed to a considerable extent in order that they should work satisfactorily. The idea of the "*politique regulatrice*" has come to the force, not merely as regards the gold exchange standard system but as regards the gold standard itself. Thus Mr. R. McKenna told us recently, that "the gold standard is by no means the automatic mechanism it is commonly alleged to be, since the Bank merely by buying and selling, lending or calling in loans, can within limits prompt an expansion or contraction of credit regardless of movements of gold".[1]

(1) Banker's Magazine, March 1927, p. 533.

It is on these newer ideals of the functions of a central bank that the Commission has built up its monetary system. In the very fore front of their Report the Commission speaks of the "exaggerated idea as to the extent to which any system of currency can be made to work automatically and independently of expert control." It recognised that, with the management of currency by such a bank, we can achieve that "unity of policy in the control of currency and credit in a modern financial organisation which can secure monetary stability."[1] As the commentator and critic of the Report to whom we have so often referred points out, there is a sharp contrast between the old idea of automatic action of currency and the new idea of management by a central bank. The old idea of automaticity has itself become obsolete to a considerable extent. "Currency control to-day aims not so much at letting spontaneous monetary movements take their natural course as at an active and anticipating policy of regulating them, employing for the purpose every available banking expedient."[2] To a considerable extent the international movements of gold are not inevitable, but depend materially upon the policy of central banks in increasing or reducing credit, and it is the skill of a central bank in adopting its action to the credit policies of foreign countries which saves undue loss or gain of gold. Dr. Sprague had in giving evidence before the Commission drawn its attention to the basic fact that "the internal advantages of the gold standard cannot be permanently enjoyed in India until the Indian people possess a banking organisation capable of discharging the international responsibilities implicit in the acceptance of the standard".

Recognizing fully the importance of the central bank in modern monetary systems and the great potentialities of such a bank in managing such systems, the Commission made it the pivot of its monetary reconstruction. But it

(1) Report, paragraphs 22 and 83.

(2) Sir J. Brunyate in Journal of Royal Society of Arts, 3rd December, 1926.

was recognised also that it was not sufficient to borrow the constitution of any foreign central banks in its entirety and to transplant the exotic in India. That course would have been easy but it would also have been wholly unsatisfactory. The proper aim was to garner the lessons derived from the great development of central banking during the last half a century, and to apply them to the peculiar requirements of India. Since in many important respects the currency and banking conditions of India are markedly different from those prevailing elsewhere, the success of any scheme for a central bank would depend upon the thoroughness with which the task of its adaptation to the environment was carried out. It is therefore necessary to refer to some of the peculiar features of the banking situation in India and to show how the idea of the Reserve Bank formulated by the Commission is adapted to these circumstances:—

(1) The first and the most obvious peculiarity is that Joint Stock Banking has been but little developed as yet, and that the rate of mortality among our infant banks is much higher even than that of the infantile mortality in our population. The obvious task before us is to impart education in the methods and ideals of commercial banking and to discover and train banking talent. It can be confidently asserted that this most important part of our task will be best carried out under the *aegis* of a Reserve Bank of the joint stock type. There have been State banks in countries like Russia and they have worked well under the autocratic direction of talented men like Count Witte. But under such a regime it is in vain to expect the growth of a strong system of commercial banking or the development of genuine banking talent and traditions. The world has not so far seen a single case of a state bank which has successfully promoted the development of a system of commercial banks or which has assisted industries on the right lines. It is on that account that the Commission did well to turn down the idea of a State Bank which was put forward before it by several witnesses.

The preference for a shareholders' bank over a State bank is also based on the very important circumstances that in India we are as yet at the beginning of the evolution of representative government. Even in countries with mature political traditions it is considered best to keep the management of the bank free from any possible control by political institutions or politicians. With the expansion in the activities of the state it is more than ever tempted "to intervene in the affairs of the central bank" and it is well to profit by the mistake of other countries and to minimise the possible evils of political pressure upon the Bank. Even if the main virtue of a shareholders' bank were to keep out political pressure that would be a great deal to its credit. It is beside the point to tell us that there was once a great state bank in Russia or that new state banks have been started in countries like Australia, Latvia or Esthonia, for there are no precedents in which such a development of commercial banking as India so urgently requires took place under the *aegis* of a state bank. Again, as Dr. Sinha has well observed "we fail to see how a directorate independent of Government control can be formed, if the state is to be directly responsible for the institution. It is curious that our politicians who are most vocal against the state control of currency are now the loudest in praising the virtues of a state bank, involving as it does state control of currency and credit".[1]

(2) In other ways, too, the Commission's scheme kept steadily in view the much needed development of commercial banking in India. It fully recognised the great value to India of the valuable and unique commercial traditions carried on by the Imperial Bank of India, and consequently based the future banking system of India not upon a central bank alone, as in so many other countries, but upon the co-operation of the future central bank and of the Imperial Bank of India. It also drew up a workable and appropriate scheme of such co-operation. The justification

(1) Modern Review, July 1927, p. 52.

of this procedure is obvious. On the one hand, it would be very difficult to transform the present Imperial Bank into a true central bank, on the other hand it is essential that as far as possible the great task of developing banking facilities which the Imperial Bank has been carrying on so far should not be interrupted. The proposals formulated by the Commission are supported by the disinterested advice of the two highest banking authorities in the world. Governor Strong urged on the Commission that the transfer of Government deposits from the Imperial Bank to the future Reserve Bank should be a very gradual process, and that at the outset the new bank of Issue should assist the Imperial Bank by large loans.[1] Mr. Montague Norman—the distinguished Governor of the Bank of England, was also for safe-guarding the position of the Imperial Bank in the process of the transfer of its functions to the new bank.[2] India cannot afford to injure its one great commercial bank which is carrying the oldest traditions in the country. Nor is it just to forget that the amalgamation of the Presidency Banks as well as the accompanying increase of the capital of the new institution took place in a great national emergency and in response to the public demand.

(3) Another special circumstance to be taken into account in the case of India was the fact that much of the banking, note issue and remittance business of the country had for a long time been carried on by the Government; and the sudden removal of such Government prestige from behind these operations might affect public confidence in their working unfavourably. Care has, therefore, been taken to secure Government assistance and guarantee wherever necessary for the Reserve bank's operations. Thus, it has been proposed that the Reserve Bank of India should be given the important right of delivering redundant rupees to the Government and of being supplied with rupees whenever that is found necessary.

(1) Governor Strong's evidence, Q. 15,416.

(2) Evidence of the Right Hon. Montaga Nonman, Q. 15,024.

(4) We cannot avoid taking account of special local circumstances in the matter of fixing the buying and selling rates for gold. The position with regard to this was so well put before the Commission by Governor Strong that his remarks might be quoted with advantage. "If it is possible to do so," he observed "it would seem to me that at *the outset* the redemption of the notes at the bank by the use of bar gold should be confined to enabling external payments to be made by the most economic possible methods by the Indian Exchange dealers *without risk of undue loss of the bank's reserve* for any purposes of domestic store of gold." He added that "if those rupees offered to the bank are convertible, so to speak, at a rate of exchange which would produce gold in London plus the cost of importation of gold into India it would involve no other measures to protect the reserve of the bank."[1] In fixing the difference between the buying and selling rates for gold, quite a number of factors have to be taken into account, the cost of transport of gold, the distance of the gold-producing country, the state of development of the local bullion market, and the demand for gold for hoarding.

Exception has been taken to the *imposition on the Government of a part of the responsibility for any rupees* that may accumulate in excess of the reserve requirements. It has been argued that the return of rupees from hoards or from circulation is likely to continue, and that, therefore, Government might conceiveably have to borrow or to resort to extensive sales of silver at a loss in order to meet the cost of withdrawal of Rupees. This line of criticism of the distribution of the responsibility between the Government and Central banks omits to take account of two important considerations. In the first place it assumes that for a long time to come the present depression will continue and reflux of rupees will go on. But there can be no certainty as to this, and any improvement in the situation is sure to carry some of the rupees back into circulation. The

(1) Evidence of Governor Strong, Q. 15,443.

"redundancy of rupees should be interpreted with full reference to all the factors in the situation." Then, again the Government of India has shown that they can make use of opportunities for selling silver without incurring losses. But finally, as against any possible losses accruing to the Government from the fact that it stands behind the bank, are to be considered the balance of the profits of that institution which will be paid over to the state. Indeed one eminent expert went so far as to observe that "generally speaking the responsibility for the silver coinage the rupees must continue to be that of the Government only."[1]

Verdict of Banking Experience and Theory on the State Bank idea.

The dominating issue in the present controversy in India is whether we are to have a state bank or an independent bank with its own capital and shareholders. In approaching this issue we must distinguish however between what is possible and what is advisable. The state bank is a perfectly feasible proposition, but it is not a proposition which is recommended either by banking experience or by economic judgment. The possibility of following a policy of compromise in India is not denied here; but it is another question whether such a compromise will be in the best and lasting interests of the country. As will be shown later, state banking has yet to justify itself and to build up sound traditions. It may be that India is to be the scene of its triumphs in future; but at the present moment we have no reason to be sure of such future developments, and we must go by probabilities which are heavily against such success, and the auspices are all adverse to launching upon such an experiment. The fact is that anything like successful working of a state bank requires the presence of some dominating personality who commands great prestige both in the state and in the banking sphere; and this country cannot be sure of always possessing such a leading figure.

(1) Q. 15,048.

So far as the evolution of central banks in the world at large is studied, the general experience and voice has emphatically decided against state banks; so that there are only a few countries—and those by no means of the first rank economically—like Australia, Latvia and Ethonia which have got state banks. Hence, if we decide on having a state bank after all, we shall have to go somewhat far a field for our model and patterns.

Nowhere has the extension of the functions of the state been more ardently advocated than in Germany; nowhere can such an extension count upon the assistance of such an expert, devoted and well organised service as in that country, and yet we find that the case against a state Bank has been most clearly and emphatically stated by the leading economists of Germany. Thus Prof. Lexis, argues that "The officials of a pure state Bank have merely to adapt themselves to the regulations coming to them from above; but a Bank of Issue with private capital, even when entirely managed by the state, has a sort of independence as regards the state—an independence which protects it against interference with the vital conditions of its existence. For the former indeed the interference of the legislature is always needed; but the latter must never forget that a great capital is in its charge. The Central Committee of the Reichsbank has undoubtedly only a very moderate authority, but its influence, nevertheless, is far greater than that of the advisory board is a state railroad Company, because it represents the owners of a bank capital." The great German economists were roused to make these protests against a state bank because the Agrarian party was threatening to convert the Reichsbank into a state Bank in their own class interests.

Such has been the experience of direct state intervention in the field of banking, that eminent bankers and great theorists are found to vie with one another in demanding the independence of banking and in decrying anything but a very moderate measure of state control. Thus, the

Governor of the Bank of England "looked upon the substantial independence of the Central Bank as the surest safeguard" against serious danger. He added that, "I should not wish to see the Bank's freedom hampered in any way—least of all by a provision that in certain undefined circumstances freedom of action might be abrogated. We have the experience in Europe that in the case of the banks in which the Government has held considerable measure of control, or there has been a limitation on the freedom of the bank, it has not resulted to the advantage of the community." Such is the voice of the *doyen* of European bankers. But he did not state the principle of the emanicipation of banks from undue state control in stronger terms than did the great economist Wagner in his palmy days, when he observed that "the unfortunate system of tutelage has never yet stood the test of practice. It merely leads from step to step, and when it has once been adopted, there is nothing in which State does not think itself called upon to interfere in the interests of the citizens, and for which the latter do not look hopefully and imploringly to the state, while they themselves limit their activity to complaints."

What, one might ask is a state bank but the conception of state control carried out to its logical conclusion and final consummation? As Schmoller puts it forcibly "All independence with respect to the State is lost when the State is lost when the Central Bank is a state bank."

Advantages of Private Capital and Shareholders to a Central Bank.

Under the special circumstances of the present controversy it is necessary to prove upto the hilt the advantages on private capital in the case of Central Bank. Before the War, Mr. Keynes in an appendix to the Report of the Chamberlain Commission reviewed the conditions of Central Banking in Europe and concluded that Continental experience suggested the inadvisability of Governments subscribing any part of the capital of Central Bank. Except in

Russia, no part of the capital of such Banks was owned by any European state. The same author quotes with approval the following arguments against the abolition of private capital of such banks. "There is first the confusion of public and private credit, to the great damage of each; for they ought to remain distinct, for their respective good and the mutual assistance which they are at times called upon to lend each other. Further, there is the acceptance by the state of a task—the task of discounting—which is not within its competence, and of which, even with the best of will, it will acquit itself badly. It is neither wise nor practicable to suppress the legitimate stimulus of private interest in such affairs as discount. It must not be believed that in such a matter disinterestedness alone suffices or can afford a better guide than the foresight of those who run the risks and reap the benefits of such operations." It is necessary to quote these views based on the Banking experience of Europe, since some well-known public men have put forward the contention in India that "with no shareholders' capital to pay dividends on, the executive of the Reserve Bank can take an absolutely detached attitude."

Let us illustrate the benefits of private capital from the example of the former Imperial Bank of Germany where the powers of the private shareholders were most circumscribed. "Nowhere else" says Schmoller, "has the influence of the shareholders been so limited, but even so it is quite sufficient to produce the required touch with the outside banking world and to secure proper and expert management." Surely that great author knew better what was happening in Germany than the local controversialist who tries to belittle the importance of the shareholders on the Imperial Bank of Germany. We are told by the latter that "although there may be on the Board some men appointed (or supposed to be appointed) by the shareholders, the Government appointees alone have all the real power. I advisedly say 'supposed to be appointed,' because it is the executive that suggests certain names, and such names are,

as a rule, accepted, as woe be to the men who would dare to defy an authority that wields such enormous power over money matters." The actual conditions in Germany are not so farcical as represented by this Indian writer, and the work of the Central Committee of fifteen elected by the shareholders in maintaining the independence of the Bank as against the state is considered of importance by such authorities on banking as Riesser, Schmoller, Conant and the National Monetary Commission of America. This is the more so because ' no business with the Empire, for the German Federated States for which unusual terms are to be made is to be transacted unless approved by a majority of the Central Committee." Thus we see that it is exactly against the financial encroachments of the State that the representative of the private shareholders of the Central Bank have been endowed with powers.

One can indeed go further and confidently assert that it would be an advantageous thing for the proposed Reserve Bank of India to have even a part of its capital held by private shareholders. Supposing that a compromise was arrived at and our Government subscribed the greater part of the capital, it can still derive much benefit from the advice of shareholders holding the rest of the capital because these latter have a direct interest in the prosperity of the Bank.

A curious arguments has been recently advanced in favour of dispensing with private capital in our Central Bank if the latter is a State Bank. Mr. Madon, a leading publicist of India, has laid down the following dictum on the subject: "Can such a bank (that is a Central Bank) work without any share capital? The answer is 'yes'. It will have all Government and semi-Government balances, and those of many public bodies, as also balances of bankers, and will thus have all the capital it needs as working resources." Need it be pointed out, as against this view that in that observation banking resources and liabilities are strangely mixed up? The balances of other

banks and of Government are of course not the resources of the Central Bank but its liabilities? As regards the capital of the Bank that is certainly a liability as between the Bank and its shareholders, but it assuredly forms a resource and a support as against all outside claims.

Do the "Special Circumstances of India" require a State Bank?

But, we have been told—though nowhere very clearly—that there are special circumstances in the case of India which require that a State Bank—and no other sort of Central Bank is to be provided for it. We therefore proceed to examine what these alleged peculiar circumstances are. Now the most prominent peculiarity of India as regards banking is that joint stock banking is very little developed in this country. But surely that is no reason for proposing to start a State Bank in it—rather it is a strong argument against a state bank. The spread of the spirit of prudent banking, the building up of sound banking traditions, the encouragement of commercial banking and the training of men who will ultimately be selected to be the managers and guides of the private banks—these are tasks for which a state bank is but poorly adapted. Magnificent system of commercial banks have grown up under the aegis of ordinary central banks—witness the banking systems of England and Germany—but we have yet to find out an instance in banking history where such systems of commercial banks rose or prospered under the wings of state banks. The truth is, that it is not within the power of a state organisation to create the spirit of banking, and in the development of a country's banking it is the development of banking traditions and spirit—and not state regulations that count.

It has been contended that it would be unfair and dangerous to transfer the financial interests of this country to the control of a group of capitalists like a

Central Bank with private shareholders. As a critic recently observed, "it is impossible to hand over to a private bank owned by a body of shareholders the huge assets of the Currency department amounting to some 200 crores." It might be pointed out here in answer to this statement of Mr. Madon that no apprehension need be entertained as regards any such predominance of the interests of private shareholders. The Report of Indian Currency Commission has provided amply against such contingencies. In the first place, the Report provides for a certain number of nominees of the Government on the Central Board which would suffice to check any policy of self-seeking by the private shareholders. But further, the Reserve Bank would, at its inception, take over many of the experienced officers of the Currency Department, and these officials would hand on the traditions of long public service to the officials of the new Bank. It can be thus seen that full precautions have been taken against any domination of private interests; and it is unfair to urge that the Report contemplates the "handing over of 200 crores of assets of the Currency Department and the many crores of Government Funds to a private joint stock Company."

It has also been argued that it is advisable to substitute a State Bank for a shareholders' Bank, in order to avoid a conflict of interests between Indian and foreign capital, to secure an Indian management as well as to ensure public confidence. These contentions are easily met. In the first place as the Report of the Currency Commission of 1926 has fixed a maximum rate for the dividends of the Reserve Bank, which is by no means large, there is no reason to expect that foreign capital will be particularly attracted to the securities of the Bank. The danger from foreign capital is only a bogey conjured up on purpose. In any case any apprehensions on this score can be set at rest by giving a preference at the allocation of the shares of the bank to the small investor, who

applies for a limited number of shares. An assignment of shares based directly on racial lines is to be deprecated; admittedly, it is impossible to ensure that shares, though assigned to Indians at first, will continue to be in Indian hands after a time. Further, it is quite possible to secure that the majority of directors of the Bank should be Indians without maintaining a racial distinction as regards shareholders. The object can be secured easily even though the bank is a shareholders' Bank; it would be preposterous to erect a State Bank only in order to secure an Indian directorate, for that object can be attained with a shareholders' Bank.

It is true that in 1913 Mr. Keynes did put forward a scheme for the formation of a State Bank in India. But that was in days when the potentialities of ordinary banking in India had not been manifested. The inter-provincial jealousies existing then must have made the prospects of anything but a State Bank hopeless at that time. Before the impetus which the War gave to the co-ordination of work between the banks and Government, and before the success of the Imperial Bank of India showed the potentialities of a shareholders' Bank as a Central Bank, it might well have seemed impossible to entrust even the Government balances—let alone remittance business or paper currency—to a bank which was not a State Bank. But, even though the circumstances of those days compelled Mr. Keynes to project a State Bank, he was firm in his view of the advantages of the Bank having private shareholders. He observes that "Continental experience suggests that it is probably inadvisable for the Government to subscribe any part of the capital of the Bank itself." In the appendix to his Memorandum he showed that in no country of Europe, except Russia, was any part of the Capital of the Central Bank owned by the State.

The Record of State Banks.

So much has been made in the present controversy in India of the precedent furnished by the Commonwealth

Bank of Australia, that it is necessary to advert to the somewhat anomalous history of that institution. As started in 1911 it was not so much an experiment in the way of centralisation of banking, as in the direction of nationalization of commercial banking. In fact it was started because the Labour Party expected great financial advantages from the entry of the State into the field of private banking. I would refer those who want to study the origins of the Commonwealth Bank to an able article by Prof. Copland, of the University of Melbourne, in the Economic Journal for 1924. He observes that the Bank "was originally established for the purpose of carrying on the ordinary functions of banking as a State institution"; and hence for fourteen years more (i.e., up to about a very few years ago) it was in no sense a central bank, and performed hardly any of the functions of a central bank. For example, the issue of paper currency was not in the hands of this bank, but was independent of it and was carried on by a Note Issue Board. This Notes Board was not associated with the Bank at all. It was a central bank only in the sense that it helped the Government in war finance operations, conducted the Government business of the Commonwealth and the six States, and the Saving Bank business. It was only in 1924 that circumstances made the absence of a central banking authority felt, and then a series of measures were carried erecting the State Bank into a central bank. The control of the Note issue was granted to it, it was strengthened by the provision of further capital and was granted the power to fix and publish discount rates. Further, with the idea of converting it into a bankers' Bank, the private banks were compelled to use cheques on the Commonwealth Bank for settling their clearing house operations. But, we have a higher authority than even that of Prof. Copland to show how recently the Commonwealth Bank has become a state bank. In December 1926, Mr. S. M. Bruce, the Prime Minister of Australia, stated that "formerly this institution was an ordinary trading bank managed by

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one man. Now it is managed by a Board of Directors who are charged with the duties of central banking. The intention is that the Board shall control credit in Australia as the Bank of England regulates it in this country, and advice is now being sought from officials of the Bank of England, as to the exact steps necessary to bring about a fully effective central banking system." (*Cf.* The Bankers' Magazine, 26th Dec. 1926, p. 820).

Thus we find that this state bank has been working in Australia as a central bank for less than five years, and that it is still so young that outside advice is being sought to make it an effective central bank. It will take some time yet to win its spurs as central bank, and no doubt, in course of time it will establish high traditions. It is too early yet, however, to cite it as a worthy precedent for setting up similar state institutions in other countries.

For a large scale and long continued experiment in state banking we have to go back to the former Bank of Russia. That was a state bank in every sense of the word. There the capital was subscribed by the Imperial Treasury and the management of the bank was entrusted to the Minister of Finance under whom was the Board of Treasury Officers known as the Council of the Bank. The arrangement was said to have "brought the bank entirely under official supervision with no external check." In spite of the great ability of finance ministers like Vichnegradsky and Count Witte little success attended the bank in its work of the promotion of a commercial banking system. More significant were the evil results of attempts made to promote industry and commerce through the state Bank, as the institution set about its task by the issue of fresh paper currency. As a historian of banking says "this new policy of the bank has been subjected to severe criticism." And no wonder, because, state banks seem apt to employ this dangerous weapon (i.e., inflation) when they are in a benevolent mood towards national trade and industry. In this connection, it should also be remem-

bered that the Agrarian party of Germany desired and attempted to convert the Reichsbank into a state bank in order to employ the funds of the Bank in the execution of their own programme." That is the besetting sin and weakness of state banks and it was well brought out by Sir Ernest Harvey, Controller of the Bank of England, recently, when he stated that "one of the main objects of establishing a state bank for the conduct of ordinary banking was that it should provide extraordinary facilities, which, whether required to foster some purely political object or not, did not possess that sound financial basis which would render the business attractive to other banks."

Considerations of space render it impossible to furnish here anything like a full record of state banking. For a complete record, the inquirer is referred to the great work of M. Raphael-Georges Levy on Banks of Issue. At p. 490 of that authoritative book the author states that "one might be permitted to believe that one of the reasons of the small amount of bills discounted by the Bank of Russia was the fact of its being a state bank; and, as regards the discounting of bills, a central bank with private capital and managed by an independent directorate would have shown greater development." M. Raphael-Georges Levy devotes the conclusion of his book to the task of demonstrating the superiority of ordinary shareholders' banks to state banks. "The state bank is a formula dear to the socialists; they would not be logical if they did not proclaim that the whole nation represented more or less by the Government has all the capacity, science and art necessary to conduct any enterprise whatsoever. But, unfortunately for the socialists, their theory is at each step contradicted by the study of the past and by the observation of the present. My labours will be amply recompensed, if I have succeeded by an impartial study of facts in convincing the reader of the dangers of state intervention and in enunciating what should be the

relations between banks issuing notes and the public finance. The service done by banks of issue is the greater according as the existence of such banks is more independent of the state and banking management is more rigorously separated from state finance. The less the state has a hand in the management of banks the better protected are the credit of the country and the wealth of the nation.'' So great is the emphasis laid on this view by M. Rapheal-Georges Levy; and he seeks to corroborate his own view by quoting the great French economist, Prof. Paul Leroy-Beaulieu: ''A country recovers quickly from the mistake of private banks, for the over-issue of such banks cannot affect conditions for very long or very much. On the other hand the mistakes of state banks or of banks closely connected with the Government (and at the instigation of, under pressure of and for the needs of Government) have effects infinitely greater and more prolonged. They throw the country into complete confusion for a number of years.'' With this statement M. Raphael-Georges Levy expresses his full agreement, and he cites numerous examples to prove its accuracy.

A New Form of "Political Pressure."

In the past, when warnings were uttered against the harm done to the cause of banking by ''political pressure,'' that danger was supposed to come from the side of the Executive. It was almost an unheard of thing that politicians in any country should demand the right of sitting on the directorate of the central banks in their capacity as members of the Legislature. The voice of experience and of sound theory warned us, as we have noted, that ''banks, and especially banks of issue should be free from political pressure.'' But certain suggestions which are being made in the case of our Reserve Bank controversy would introduce that political pressure in its least desirable form—in a party form as well as in a personal form. For, the panel which is to be put forward by the Assembly, as proposed, would naturally include men

chiefly from the dominating party of the day. What is more, through the personal and direct action of the party members thus sent on to the Board of Directors, the eddies of political feeling and antagonism would act directly on the policy of the Bank. This would do great harm, even if the policy were adopted in a country like England with its innate conservatism and fixed political traditions formed through centuries of parliamentary life. The danger of the course would no doubt be greater in India where—be it said with all respect—the legislature is still young and unused to the heavy and continuously increasing work which is being piled on it.

It has been contended, that by the disqualification of our legislatures, the Reserve Bank will be deprived of the services of a class specially versed in public affairs and finance. But it might be rejoined to this, that our legislators are not mostly men belonging to a leisured class, but are men belonging to professions or business class, who are, with all their abilities, hard put to it to discharge their duties as legislators as well as to carry on their private work. To pile on a fresh and exacting set of duties on them, as directors of the Central Bank, would be hardly fair either to them or to the Bank. Nor is this all; for experience in one or two other countries has shown that the retention of legislators on the boards of central banks "easily leads to party nepotism." Finally, is it fair or just to assert that, outside the legislature, India cannot find sufficiently capable men to furnish the directorate of a central bank?

The most important consideration to be borne in mind in this connection is that monetary issues are quite capable of becoming first class political issues at any time. That has happened repeatedly in other countries. Thus Bimetallism was a political issue for many years in the United States; and inflation is a disguised political issue in many countries at present. Under such contingencies it is pecu-

liarly harmful to have politicians on the boards of Central Banks.

If put into operation, the schemes of control for our Indian Reserve Bank, which have been put forward recently would form a remarkable contrast to the constitutions of all the other central banks in the world. In one or two of the dominions, it is believed that the Central Banks have not been unaffected by political pressure; but India would be the first country in which the members of legislature *as such* are to figure on the Board of such a bank. Even in the case of Australia—which has been so often quoted as a precedent by advocates of a state bank—the Secretary of the Commonwealth Treasury is a member of the Board of Directors, and all the members of the Board are appointed by the Governor-General—six of them being persons actively engaged in agriculture, commerce, finance and industry.

We should not forget that the admission of a few members of the legislature on the directorate of the Bank can be but the thin end of the wedge, and that the most probable result of the surrender of the principle as regards keeping out all political pressure would be to have a majority of politicians on the managing board. It is instructive to read what the leading commercial journal in India has to say on the subject: "It is true that nominally (under the Malaviya scheme) the Legislatures would elect only five in the Board of fifteen members; but, as outside bodies would, under the amended Bill be at liberty also to nominate M. L. A.'s and M.L.C.'s, it would in practice be possible to appoint at least three additional directors of the same genus, *viz.*, one by the Indian Chamber of Commerce, one by Joint Stock Banks with rupee capital, and one by the provincial co-operative banks. On that basis the *politicians on the Board would form a majority.*"

An unexpected, but strictly logical, consequence of the proposal that members of our legislatures should be placed

on the Board of the Reserve Bank made its appearance without loss of time. It has been proposed almost simultaneously with the original proposition that out of the fifteen Directors at least three should be Moslems. The further idea has been put forward without delay that a Moslem and a non-Moslem should be appointed alternately as either the Governor or the Deputy Governor of the Reserve Bank. In fact this corollary has followed with surprising rapidity on the main theorem. And if, indeed, the positions on the Board are to go not by considerations of Banking efficiency but on grounds of political representation, we open the door to all sorts of political as well as quasi-political claims. If politics makes its way into the Reserve Bank, can Communalism remain far behind?

Let it be added, that in the interests of the legislature itself, of its efficiency and dignity, it should pass a self-denying ordinance as regards the presence of its members on the Bank's Board. The legislature is elected by the whole country to regulate the affairs of the nation impartially, from its detached eminence. But if it once steps down from its pedestal to elect members to the Board of the Bank, how can it remain an impartial judge of the work of that bank? By the fact that it has elected members to the Board of the Bank it has shared the work of the bank, and cannot with propriety sit in judgment on the work of the Bank. Those who are always expressing apprehensions as regards "vested interests" should see to it that the legislature itself has no vested interests in the Central Bank.

We in India are justly proud of the high character and disinterestedness of the members of our legislatures. All the same it behoves us to draw the proper lessons from the influence exerted on banking evolution by the politicians of other countries. Here is the considered opinion of Mr. H. Parker Willis—the eminent historian of American Banking—as regards the unfavourable influence exerted on banking in the United States by the interference of politicians. "Among those who most retarded the development of the

Federal Reserve System and its introduction of forward-looking ideas, a high place must be given to the politicians who at first put themselves forward as radical reformers. It was Secretary MacAdoo who was most reluctant to effect the transfers of the Government funds to the reserve banks, and Comptroller Williams who was slowest in accepting the mandate of the Act by giving to them (the reserve banks) credit data concerning member bank conditions which they needed in order to build up their files. It is the supposedly popular or democratic members of Congress who have been most abusive toward every forward step in the process of popularising the banking system and who have been most inclined to take the part of the special interests."

Reform of the Paper Currency system.

We have seen how, under the inspiration of the Report of the Currency Committee of 1919, the Paper Currency Act of 1920 was passed, which contemplated an overhauling of the Paper Currency system that had been long overdue. Nevertheless, in effect, that Act only set up through its permanent provisions an ideal to be approached through long years of effort. The permanent provisions did indeed provide for a proportionate fiduciary issue, for a limitation on the amount and character of the securities in the Paper Currency Reserve, as well as for a reduction of the created securities. Elasticity was to be secured by Emergency issues against commercial bills. But the circumstances of the day made this permanent constitution a very distant ideal indeed. While created securities even rose in amount, the crediting of interest from paper currency securities was virtually adjourned *sine die* since their interest was credited to revenue. In 1925, again, the limit of the permissible fiduciary issue was raised to 100 crores. This method of obtaining elasticity is of doubtful value more especially if the object aimed at is the relief of seasonal stringency; and it is well not to confuse a permanent increase in demand for money with a short period one. Nor did the emergency currency, as designed by the act and expanded later, prove

such a complete solution of the seasonal problem as it was expected to be; since it might quite conceivably lead to a diminution of the foresight formerly exercised by the banks as regards provision of liquid funds against times of stringency. In effect, then, the legislation of 1920 did not quite succeed in the task of effecting a radical reform of our paper Currency system. It was necessary, in the first place, to keep apart the resources of the paper currency system from the general financial resources of the country. Experience also showed the desirability of not fixing the Emergency issue at some arbitrary figure or at an amount which could be increased indefinitely according to the demands of certain business interests. Rather its amount should be determined by the prudent policy formulated in advance by a central bank which was fully in touch with trade and banking circumstances. At the same time, of course, it is best based on self liquidating bills—a procedure which should secure a proper correlation between the volume of foreign and domestic trade on the one hand and currency on the other. It is not merely elasticity of currency as such that has to be desired and secured, but elasticity based on sound principles—an elasticity not based on arbitrary increases of the fiduciary issue or on arbitrary alterations in the volume and scales of the emergency currency such as had been tried already, nor an elasticity which would tend to defeat its own object. In fact, it is only a central bank which can manage the currency system properly in the light of its direct contact with the business world including other banks. It can judge best of the elasticity required, it can base it on proper bills and securities, and it can see to it that the elasticity was not either abused or stultified. It is on these lines only that the longstanding problem of seasonal stringency can be solved, and other demands for additional paper currency can be most advisedly met.

The main plank of the Royal Commission's programme of paper currency reform is, therefore, the transfer of the sole right of note issue to the proposed Reserve Bank. Look-

ing to the close interrelation between the discount policy, the volume of credit and the note issue, one is justified in calling this reform the fundamental one. The Chamberlain Commission had recognised that in the matter of note issue as in other aspects of the monetary system of India "the difficulties and inconveniences which arise are largely contingent on the absence of a strong central banking institution competent to manage the note issue." Admittedly, in the absence of such an institution the recommendations made by that Commission for the improvement of the Paper Currency system were only palliatives. For it cannot be too strongly emphasised that the functions of managing the note issue and of controlling other varieties of circulating media or credit cannot be separated.

The other lines of reform which the Commission has projected as regards the paper currency system might now be summarised. The most important of these recommendations is the proposed adoption of the *Proportional reserve system*. There is no occasion to go into the details of the controversy which has raged as regards the respective merits of that system and the fixed fiduciary system. Even in England there have been powerful advocates of the percentage reserve system which undoubtedly secures greater elasticity. But it may be admitted that, in the case of a country like Great Britain, the fixed fiduciary system might be preferable, since the "variations in the internal demand for currency in England are comparatively slight, whilst the demand for gold for export is highly variable and is a matter of far greater importance than in any other country." There is the further consideration that in England "the rigidity of the Issue Department is tempered by the elasticity of the Banking Department."[1] Hence the fixed fiduciary system might be well suited to the special wants of such a country. On the other hand, in countries where the seasonal expansion and contraction is particularly pronounced, owing to the mainly agricultural charac-

(1) Messrs Kisch and Elkin, *Central Banks*, pp. 86—89,

ter of its internal economy, the proportional reserve system is to be perferred as leading to the requisite elasticity. Whatever then might be the choice of an exceptionally situated country like England, the recommendation that India should adopt the Proportionate Reserve system is based on the need of elasticity on the part of a mainly agricultural country, which has to expand her currency periodically in order to finance her harvests. It might be remembered that the movement away from the fixed fiduciary system was initiated in the Annexe to the Report of the Chamberlain Commission; it was carried out partially on the recommendations of the Currency Committee of 1919; and that by the Paper Currency Act of 1920 the fiduciary reserve was not to exceed 50 per cent. of the total circulation. The recommendation of the Royal Commission carries that policy to its logical conclusion. A further provision for elasticity is contained in the recommendation that *self-liquidating bills* should form an important part of the reserve. This furnishes a suitable instrumentality for the contraction and expansion of currency in accordance with seasonal and other needs. Bank notes based on such paper to a material extent will pass the tests both of elasticity and responsiveness to the needs of trade. Here, following the best foreign examples, the proposed Indian Reserve Bank will make a due and proper use of the principle of "Productive Credit" as regulating its policy, though of course the principle needs not be applied too rigidly. Until, however, the habit of drawing bills can be fostered in India and a sufficiency of suitable bills are available, the elasticity secured in this way will be some what limited, and there need be no reasonable ground for the fear sometimes expressed that this provision coming on the top of the recommendation regarding the proportional reserve system will lead to an excessive elasticity of our note issue.

The *ad hoc* securities in the Paper Currency Reserve had of course to go. They had been condemned generally, and they formed the most unsatisfactory feature in the

composition of the Paper Currency Reserve and a relic of the era of inflation. The act of 1920 had already arranged for their cancellation and the Commission of 1925 proposed that they should be replaced within 2 years by gold securities. Hence if the Government should meet with difficulties in cancelling the securities at once a two years period of grace was allowed for the process and for their replacement by securities of an eligible character.[1] Looking to the large amount of such securities (7 crores) and the difficulties which have so far prevented their cancellation, the two years' interval cannot be regarded as unreasonable.

The *amalgamation* of the Paper Currency and Gold Standard Reserve was another measure which had along been over-due. The Chamberlain Commission had contemplated that step, but at that time certain preliminary conditions of the amalgamation had not been fulfilled and the measure if adopted at the time would have been premature. In particular, as long as the Gold Exchange Standard prevailed in India it was necessary to keep the two reserves apart. These conditions and pre-requisites can now be said to have been satisfied. It has been recommended that the paper currency should cease to be convertible by law into silver coin while both the rupees and notes will be redeemed in gold bullion from the same reserve. Again, the future Reserve Bank will be the sole authority to control and work both the note issue and the rupee circulation. Under these altered circumstances there are no obstacles left to the proposed amalgamation. It has been objected that the amalgamation imparts an uncertainty to the reserve, the rupee liability being quite an uncertain amount. To this contention the reply is that the rupee liability has been placed mainly on the Government. It has also been objected that it would be an anomaly to hold a part of the combined Reserve in rupees when that reserve has a liability both as regards rupees and notes. But it might be pointed out that the rupee coin in the reserve is not to exceed 10 per

(1) Report, Paragraph 145.

cent. of the whole, while gold is held in the reserve on very conservative lines and in substantial amounts.

It is in this double capacity that we have to consider the *Currency Reserve, its size and composition.* It has been suggested by Mr. Hawtrey that the gold to be held in the reserve is excessive in amount, and indeed that the wisest plan would have been to dispense with the 22 millions of gold already held. But as against this the Commission has pointed out that the obligation laid on the Reserve Bank is to be far more heavy and serious than has ever been imposed in the past on the currency authority in India. The obligation is to convert currency not merely into foreign exchange but into metallic gold, and it is an obligation that is not, as formerly, conditional and circumscribed but absolute and unlimited. There is no limitation imposed as to the purpose for which gold is to be given out. A large gold holding is also wanted to secure public confidence in the note and in view of the new status of the note. Instead of relying on foreign holdings of gold India might well elect to become an independent support and buffer of the new gold standard system, in view of her importance and size. Indeed the highest banking authority in England, the Governor of the Bank of England, has suggested that the minimum reserve should be 40 per cent. "mainly in gold", and only partly and to begin with in gold securities. He added further that "by degrees the whole 40 per cent. should come to consist of gold". There can be no denying that, in the special circumstances of India, a larger proportion of gold must be kept in reserve than is desirable in case of some other countries. For public confidence has to be assured in a radical change both of monetary system and in the controlling authority. It was to ensure this confidence as well as the uninterrupted evolution of the new system, that the Commission had to lay down definite rules for the composition of the Reserve. Such a statutory control of the reserve had been long demanded, and was particularly necessary when the new currency authority was to enter on its great task handicapped by the accumulated prejudices of several

decades. Obviously, also, in view of the alterations in the currency authorities' obligations only a small amount of the reserve could be held in silver. It was in view of this important consideration, and also in view of the fact that there was a very large number of rupees in the reserves, that the Commission had to outline some apparently rigid stages for the reduction of the rupee reserves. Nor is there any danger that the Commission's scheme of statutory reserve—proportions would materially "immobilise the reserve." The Reserve Bank, according to the scheme, will maintain a reserve of gold and gold securities of not less than 40 per cent. of its liabilities. But it is also required to keep "a good margin above this minimum requirement." Indeed, the authorities are to strive to work to a reserve ratio of from 50 to 60 per cent., and no favourable opportunity of fortifying the gold holding in the Reserve is to be allowed to escape. With such a large margin, and with the rest of reserve invested in self liquidating bills and good securities, it is difficult to imagine circumstances when the reserve could be "immobilised." Any way, comparing the present scheme of composition of the reserves with those devised for other countries, the amount of free resources are larger in the former, and hence the possibility of immobilising of reserves is less. A good test of the merits of the plan of the Commission for imparting elasticity to the Indian Paper Currency system is the novel and unexpected character of the criticism directed against it. For decades the only criticism heard against the system was crimed at its rigidity and inelasticity. Now, however, some judicious critics are found to argue that with the Proportional Reserve system and the self-liquidating bill issue which might amount to 60 crores, there is "an extraordinarily liberal provision of elasticity."[1] It might, however, be pointed out that the Commission's recommendations were not only meant for the near future, but for a developed system with a powerful central bank, an organised money market and a sufficient expansion of the use of bills.

(1) Prof. Das Gupta, *Paper Currency in India*, pp. 284—285.

A large bill market is at present conspicuous by its absence in India, and the prevailing methods of doing business are not favourable to the production of a large supply of bills. Too high immediate expectations should not therefore be entertained of the elasticity secured by the introduction of this particular method. When we have due regard to this important factor the margin fixed for elasticity cannot be said to be excessive.

Some critics of the Commission's recommendations.

It is time to turn our attention to some friendly and highly suggestive criticism of the currency scheme of the Royal Commission coming from Sir J. Brunyate, Sir C. Addis and Mr. Hawtrey and other advocates of the Gold Exchange Standard.[1] Criticism coming from such masters of monetary theory and practice deserves to be considered and studied very carefully indeed. Their arguments are directed from the point of view of scholars convinced of the potentialities and merits of the Gold Exchange Standard. As Sir James observes "I think personally that the Commission's decision that India's gold holding should be really substantial is right. But the Report fails, perhaps, to supply an adequate statement of the good case which could be put up on the other side, i.e., for an exchange standard on the lines of the Geneva Conference resolutions."

This is a point of view with which one can heartily sympathise, for there were great potentialities in an improved Gold Exchange Standard, and the old standard has in its time deserved well of India. It worked as well as any standard then known could have; and it has that achievement to its credit in spite of the want of suitable support from a central bank and of some want of the public confidence in its earlier days.

To come however, to the criticism directed by Sir J. Brunyate against the Gold Bullion Standard, we find that

(1) Journal of the Royal Society of Arts, 3rd December, 1926.

the chief count against it is that it is not intelligible to the uninstructed, that the convertibility which is one of its chief merits is not direct and clear, and that the gold basis for the rupee which it provides is not conspicuously visible. But, surely, it might be answered that a standard under which gold is given for export and for other uses is simpler and more intelligible to the man in the street than one under which the local currency commands and procures exchange on foreign countries only. And it might be added that a system under which the local currency can be exchanged for gold has a convertibility not more remote but of a close and direct order. The direct power to export or import gold must necessarily make a stronger appeal to the multitude than the mechanism for the mere transmission of bills payable in gold.

Sir James is in fact advancing here the same argument which Mill put forth against Ricardo's currency scheme. "A still stronger consideration" says Mill "is the importance of adhering to a simple principle. Every one can understand convertibility. Regulation by the price of bullion is a more complex idea and does not recommend itself through the same familiar associations.'"[1] In spite of this, however, England has adopted the Gold Bullion Standard with success; and to the Indian population which has been accustomed to the working of the Gold Exchange Standard for thirty years the new system of convertibility into gold is really a simplication of an old problem.

The task of meeting the criticism of such an authority on Indian monetary matters as Sir James Brunyate is made easier by the fact that we have access to his own well-stocked armoury and can employ weapons forged skilfully by himself. Let us then ask what deficiencies Sir James himself saw in the pre-war currency system of India, and on what lines he himself proposed to remedy them. If after examining his own ideals we can show that they are all to be

1) From the *Fortnightly Review*, July 1879, p. 33.

found embodied as conspicuous features of the Gold Bullion Standard, then we shall have fully vindicated that Standard as advocated by the Commission. Let us then enumerate his own suggestions for the perfecting of the former currency system of India. They are to be found in paragraph 21 of his valuable memorandum for the Royal Currency Commission, as also in his answer to Q. 11.325 in the evidence before that body. His most important suggestion is that reliance should be place for the support of Indian Exchange on gold issued for export rather than on the grant of sterling credits. As he stated it very briefly and lucidly, "the system we had before the war practically never worked with gold exports at all, and with some hesitation I have suggested that in supporting exchange under our new system we should rely mainly on gold exports." (Q. 11,325). It scarcely needs to be said that this is exactly what the Gold Bullion Standard proposed to do. Gold will certainly be made available freely for exports, and as Sir James has himself observed later, "the sales for delivery in London are intended to serve a monetary purpose, and the rate which would be natural under a gold exchange standard will apply." It might be pointed out that a system of sales of gold for export might surely claim to be "intelligible to the uninstructed", and might well form a gold basis for the rupee which is conspicuously visible. A third line of improvement proposed by Sir James is thus indicated: "The system we had before the war was one in which we were constantly pouring large quantities of our own gold into circulation. The system......I recommend is one in which I do not propose that that should be done" (Q. 11,325). Now it can be claimed with justice that the Gold Bullion Standard, as a system, satisfies this condition at least as well as any other system. There is no possible room in it for a gold currency. In fact the legal tender quality of the sovereign is expressly removed. The circulation of gold is entirely inconsistent with the working of the new standard.

Another suggestion from the same source is to the effect that any real gold or gold exchange system could only be based on the principle of the unlimited issues of gold for export and import; the system of reverse remittance savoured of the "dole" and should be discarded. Such a basis for the gold standard system has been provided, and the Commission has arranged for the required, "absolute guarantee as to the free interchangability of domestic currency and gold bullion."

But it has been contended by some other critics that sales of gold to satisfy the internal demand are meant to be at a deterrent rate, and that such a policy is against the ideal of linking the currency to gold. There is more than one way of meeting this particular argument which, by the way, has been advanced in India too. In the first place, as Sir J. Brunyate has well pointed out, "the sales of gold in India will not be the actual means by which the gold standard is supported." But, further, as he agrees, there are the most cogent arguments to justify "the necessity for a deterrent rate in the case of sales for India. The grant of parity terms would destroy the bullion market." I would venture to add that any particular rates for the sale of gold for internal use are not of the essence of the Gold Bullion Standard scheme, but only a very important detail which could be altered after due experience is gained in course of time. If, as Mr. Hawtrey has anticipated, the result of the currency authority in India buying gold at par in Bombay will be to secure a perpetual stream of gold from South Africa into India replenishing the Indian reserves, the rates for the sale of gold in India could be made as little deterrent as circumstances permitted.

After observing that India absorbed 20 per cent. of the world's total production of gold during the five years preceding 1914, and 29 per cent. during the corresponding period preceding 1924, a writer in the Journal of the Institute of Bankers proceeds to justify the rate fixed by the Royal Commission for sales of gold by the Reserve

Bank. "The only way in which the bank can be freed from the constant drain for non-monetary purposes is to ensure that the selling price shall always be such that it is possible for the bank to replenish its stock of gold by importation from London. Accordingly, it is proposed that the selling price of gold in Bombay shall be the buying price of Rs. 21, 3 as. 10 pies per tola, plus an amount corresponding to twice the cost of importing gold from London. This stipulation, however, does not mark a departure from the principle of a gold standard, but is, in fact, a provision which would have to be made in any case for the safeguarding of the banks' reserves, irrespective of whether gold was in circulation or not." (Cf. the Journal of the Institute of Bankers, February 1927, p. 77).

Finally, it might be suggested that too great emphasis need not be placed on any one link proposed to be formed between the rupee and gold. *The Commission has provided a number of such links or points of contact* and regard must be had to their cumulative effect. To start with, there are the sales of gold for delivery in London; then there are the potentialities of sales of gold for internal uses. Add to these the much larger gold holdings in India to support the obligation of the sales of gold both in and out of the country. Finally account is to be taken of the removal of the former legal obligation to convert notes into silver coin and of the imposition of the new obligation to convert them into gold bullion. It cannot seriously be contended that, in spite of these cumulative features, the gold basis which has been provided for the rupee will still fail to be conspicuously visible. The connection between gold and local currency has been made evident at every point of the scheme of the Commission. It has been justly remarked by Sir J. Brunyate that "one of the main objects of the Commission is the basing of every part of India's monetary system upon gold, though the mere facade of a gold currency is refused." In the light of all these factors, the large gold holdings, and the sale and purchase of gold, it seems not at all likely that

the convertibility will appear either remote or perplexing to the public. Thus all the tests laid down in the light of past experience for improvement of Indian Currency are satisfied by the Gold Bullion Standard, and that is why our most enlightened critics are generous in their praise of the system as a whole. As Sir James observes: "The standard, as the commission rightly claim, is based on gold and not on Sterling. The two main undertakings will be made effective by means of an appropriate reserve and the Central Banking scheme, and India will possess a system as advanced as and essentially similar to, those of gold standard countries such as Great Britain and the United States of America. This means efficiency not of a rough and ready kind, but scientific and refined. It should also mean finality. The full establishment of the new system should close the agitation over India's monetary problem."

It has also been contended by some our critics that "the sale of gold in London was a pure fiction. It was a sale of sterling since "gold and sterling in London were one and the same thing." The inference sought to be drawn from this was that the difference between Gold Bullion Standard and the pre-war standard was not very great and that the rupee will remain limited to sterling and not to gold. The obvious reply to this train of reasoning is that, in normal times, there is, of course, no difference between gold and sterling. When, however, in some great crisis sterling and gold part company, the obligation of the proposed central bank to give gold for export will assume its full significance.

The criticism of the Gold Bullion standard by the advocates of the Gold Exchange Standard, with which we have dealt above, will help to clarify the conception of the Gold Bullion standard in India. A great many critics of the new standard in India identify it with the Gold Exchange standard and profess to regard it as a piece of camouflage. To them the difference is only between

tweedledum and tweedledee and the new standard is supposed to be only the old one presented in a new guise. The vigorous criticism of the proposed Gold Bullion Standard emanating from stalwart and eminent champions of the older standard like Sir J. Brunyate and Sir C. Addis should help to reassure them and to convince them that they are not dealing here with a distinction without a difference. In fact the Gold Bullion Standard differs as we have seen in many important respects from the Gold Exchange Standard as it was worked in India before the war.

There had been some misconception about the recommendation that the Government should guarantee the note issue, and it had been argued that the Government was "guaranteeing payment in actual gold with quite a modest gold holding." In meeting this objection we have to remember the general agreement on the point that the State is to stand behind the Bank, and to receive all the profits over and above a moderate percentage which goes to the shareholders. In fact the larger proportion of the profits of the paper currency system are to accrue to the Government. Need we wonder then that it can be called upon to guarantee the note issue? Be it noted also that the guarantee is only a supplementary one, and has to be met only after the bank with its admittedly very large gold reserve has failed in the task. Indeed the chances of this guarantee being enforced are extremely remote. Mr. Keynes in the annex to the Chamberlain Report had pointed out the very remote contingency of the guarantee laying any additional burden on the Government. He added, however, that "if the Bank were, by a violent chance, to get into difficulties, there cannot be the least doubt that the Government would have to maintain the solvency of the note issue whether they had formally promised to do so or not."

It might be added that, speaking generally, the Gold Bullion Standard has met with a favourable reception from our economic experts in India. It was recognised by a great many Indian economists that the currency system

which was recommended by the Commission was an effective gold standard which would give India "all the advantages of a gold standard without a gold currency", that under it the expansion and contraction of the currency will be automatic and that the scheme will ensure the free inflow and outflow of gold. It was indeed only to be expected that the new system of currency would be welcomed by a large number of our economic experts seeing that it realises and incorporates the suggestions made by so many of them before the Currency Commission. It might be permitted to quote in this connection a number of constructive suggestions placed by such experts before that body which virtually form so many anticipations of the Gold Bullion Standard. Thus a well-known Indian economist told the Commission that "the adoption of a gold standard does not mean also the keeping of gold coins in active circulation..........If we can have a gold standard with paper currency backed by a reserve of gold and securities easily convertible into gold that would be as effective or even more, and certainly more convenient and economical than such a standard with gold coins in circulation. The craving for the social use of gold as well as the traditional habit of hoarding are detrimental to the employment of gold as currency in this country. Coins intended for circulation will almost certainly go to the melting pot. And there will be in consequence imperceptible deflation of the currency with all its attendant evils". The merits of the Gold Bullion Standard and the harm which would be done by permitting a gold currency to co-exist with it could not have been better expressed. That view was corroborated by another of our leading economists who observed that "by a gold standard we mean not the actual extensive use of gold in currency but a system under which the media of exchange can be ultimately converted into gold for international payments and also for internal payments. It was also an Indian economist had put forward the view that it is enough to have a convertible rupee, convertible not in gold coins but in gold

bullion only" While a colleague amplified the suggestion and made it clearer by adding that "the Government shall undertake the obligation to give for external purposes gold in the form of bars say of 100 oz.". Nor were there wanting other anticipations of the new currency standard. The main defect of the older system was said to be that "the absence of a legal obligation on the part of Government to give gold for rupees does not secure the automatic stabilisation of the rupee". The former Gold Exchange Standard was alleged to have encouraged hoarding because "people have no confidence that gold, once they part with it will come back to them". That objection could, of course, not apply to the new standard under which the currency authority will undertake an obligation to sell gold. Other features of the Gold Bullion Standard were also anticipated. The desirability of imposing an ultimate limit on the legal tender quality of the rupee was emphasised while it was urged that no currency should be issued in future except against gold. It is the merit of the Gold Bullion Standard of the Commission to have incorporated all these constructive suggestions.

Nevertheless some aspects of the new standard have been submitted to criticism in India; and it is advisable to meet such criticism here. In the first place it has been contended that the Gold Bullion Standard is a mere "abstraction" in as much as under it gold will only be sold by the currency authority in large bars worth a few thousands of Rupees. The obvious reply is that from such a point of view the standards of currency in most advanced nations can only be regarded as abstractions. A leading economic journal when discussing the recent introduction of the gold standard in England gives an effective reply to the criticism which has been referred to. "Any citizen by saving up some 1,700 currency notes will be able to exchange them for bullion for use at home and abroad. Every individual pound note is therefore given a guaranteed value in terms of gold, and the essential conditions of convertibility are

restored.'' Obviously it is no part of the functions of a scientific system of currency to meet the non-currency demand for or to facilitate the acquisition of gold by individuals for non-monetary purposes.

The demonetisation of the sovereign has also been objected to by some critics. But since the importation of sovereigns on a very large scale has been going on for decades and since a large proportion of such sovereigns must necessarily be still held in hoards, their demonetisation was absolutely necessary if the action of the currency authority in expanding or contracting currency was to be effective. The choice lay obviously between the retention of the legal tender quality of the sovereign—a matter of no real economic advantage by itself—and the establishment of an effective and automatic currency system.

Apprehensions have been expressed regarding the proposal of the Commission regarding the withdrawal of the present legal right to obtain silver rupees in exchange for notes. But obviously the retention of the obligation to convert notes into silver would have ensured the continuance of the domination of silver in our currency system and would have kept that system tied down to the white metal. While the Commission has taken care to ensure that all reasonable demands of the public for metallic currency should be met in practice, it could not ignore the consideration that the main condition of the existence of a true and advanced gold standard was the convertibility of notes into gold. The criticism is in fact based upon a misconception of such a standard; and the critics forget the case made before the Commission by leading Indian economists for "a gold standard with paper currency backed by a reserve of gold and securities easily convertible into gold".

Some critics while recognizing the impossibility and even the undesirability of having a gold currency have proposed to supplement the Gold Bullion Standard by the coinage of a "theoretical Gold Mohur". According to them

such a device is necessary to enable people to realise that the country has a gold standard. While the suggestion is well-meant its practical value, if it is adopted, is likely to be very small. If the constant purchase and sale of gold by the currency authority and the convertibility of notes into gold are not adequate to convince people that the country is on a gold standard little could be expected of a coin which the great majority will have few opportunities of seeing or possessing.

The Ratio Controversy

The scheme of monetary reconstruction which the Royal Commission on Indian Currency put forward was a very comprehensive one; it contemplated among other things the establishment of an up-to-date and automatic currency standard, the constitution of a currency authority in the shape of a Reserve Bank (which should combine the control of currency and credit), and the thorough overhauling of the paper currency system of the country. Nevertheless the controversy which followed the publication of the Report of the Commission has raged only around two points of this programme—the ratio and the constitution of the directorate of the proposed Reserve Bank. The surprise with which one regards this selection of two apparently isolated points of the programme for criticism is, however, removed when we remember that the controversy in India over the ratio question is the counterpart of the great struggle which has taken place in most countries after the war between the advocates of inflation and those of the return to a steady and moderate price level. It is also significant that the same set of critics who argued for the reversion to the lower ratio (with inflation as its corollary), also worked for the object of placing legislators on the directorate of the Reserve Bank and of thus bringing political pressure to bear directly on our future banking policy. In fact, the real issue in the controversy is that of inflation; and that fact accounts in the main for the vitality of the contro-

versy. For, if adjustment of prices to the ratio was indeed the real issue, few would be found to assert in this year (1929) that things had not adjusted themselves in a preponderant degree to a ratio which had held the field for five years, and the controversy would have died a natural death before now. But the ratio controversy derives its whole vigour and momentum from the inflationist aspirations behind it; it is the Indian counterpart of the struggle over readjustment of price levels to normal conditions which has been the most important economic movement of the post-war epoch in most countries of the world. It is on that account that the present controversy will occupy a not unimportant place in the economic history of India.

The "Natural" Ratio

There has been much misunderstanding over the character and origins of the former 1s. 4d. ratio. Thus that ratio has been called the "natural ratio" and "the permanent ratio." It has been even confused with the currency standard itself, and in the Minority Report of the Currency Committee of 1919 it has been called the "standard ratio." But a glance at the history of the ratio will show that those who proposed and sponsored it expressly disclaimed any permanent character for it. Thus the Herschell Committee was careful to explain the character of the ratio in its Report. "It would not, of course, be essential to the plan that the ratio should never be fixed above 1s. 4d.; circumstances might arise rendering it proper and even necessary to raise the ratio." So also the Fowler Committee was careful to emphasize the necessity of "the final ratio being fixed either below or above 16d., as further experience might show to be expedient." It added further that "between the rate of today and that determined by the bullion value of the rupee, there is none that can be described as natural or normal."

The advocates of that ratio would also do well to remember that the Fowler Committee in deciding for a 1s. 4d.

ratio employed the very same arguments which were used by the Currency Commission of 1925-26 in order to justify the present 1s. 6d. ratio. The Fowler Committee expressly overruled every plea and answered every argument that the opponents of the 1s. 6d. ratio have put forward in our own days. Thus the Committee's main argument on behalf of the 1s. 4d. ratio was that "the rate of 1s. 4d. is that of the present day; prices in India may be assumed to have adjusted themselves to it, and the adoption of a materially lower rate at the present time would cause a distinct and, in our opinion, a mischievous disturbance of trade and business." Another ground on which the Fowler Committee recommended the 1s. 4d. ratio was that in 1898-99 the prevalence of that ratio was found to be compatible with a large favourable balance of trade. The pleas that "the *status quo* had not been arrived at without manipulation and that a *fait accompli* in the shape of an established ratio and a price adjustment thereto had been presented to the Committee" were also overruled by that Committee. Not only is there a close and instructive parallel between the arguments employed by the Fowler Committee and the Royal Currency Commission of 1925, but the case for a 1s. 6d. ratio was much stronger in 1926 than that for a 1s. 4d. ratio in 1898. Little statistical proof was brought forward in 1898 regarding the adjustment of prices to the older ratio, while the ratio itself had been prevailing only for about a year. Finally, the rise of the ratio to 1s. 4d. in 1898 was a very slow and hesitating affair, indeed, compared to the attainment of the 1s. 6d. ratio in 1925.

In the light of the above historical examination of the reasons for the establishment of the 1s. 4d. ratio in 1898, we can see how little ground there is for the contention that any later change of the ratio constituted "a wanton tampering with the standard of value." Gold has been restored as the standard of value in India, and gold will be—with the adoption of the proposals of the Commission of 1926—more than ever the basic currency "from which the

other monetary instruments derive their own exchange value owing to convertibility.'' The essence of the gold standard is the tying of the value of our monetary unit to the value of gold. But it cannot be contended that any particular ratio once adopted should or could be maintained for ever, regardless of important changes in prevailing conditions—for example, great changes in value of precious metals. The factors which the Fowler and Herschell Committees took into account in recommending the 1s. 4d. ratio show that in their view the ratio was not either unalterable or of the essence of the currency system; for they based it professedly on a consideration of the prevailing facts of their own day as regards prices, trade conditions, and the relative prices of the precious metals. It is, of course, true that a standard unit of value once adopted should not be arbitrarily departed from; for any random changes in the standard of value are sure to cause losses to some people. So far one can respect the zeal shown for the older ratio. But the changes in our ratio in India have been such as were absolutely necessary in the interests of the stability of prices—*i.e.*, of social justice. A statistician would be staggered at the number and the size of the fluctuations of prices which India would have experienced if she had adopted the policy of sticking to the old ratio at all costs since the war. It is true that the 1s. 4d. ratio held the field for nearly twenty years; but it need not be forgotten that more recently it was in abeyance for a whole decade—and for a decade which has seen currency and trade changes enough to crowd a century. Under these conditions the currency authority which is proceeding to stabilize the ratio would be well advised to consult the facts of the day for his guidance rather than the conditions prevailing three decades ago. In such an important affair those who admire the work of the Fowler Committee would do well to imitate its procedure.

Those who argue for the maintenance of 1s. 4d. as a natural ratio certainly ignore the fact that there is a dynamic side to the problem of the ratio of exchange under the

Gold Exchange Standard. To this aspect attention has been recently drawn by Prof. Taussig, a distinguished economist, in his discussion of the Gold Exchange Standard. He has urged that the maintenance of the fixed rate of exchange depends upon the continuance of certain fundamental conditions; "changes from any established situation, any current rate of exchange, *however firmly it seems to be imbedded,* do occur. Demands will change, new articles of export and import will appear, the balance of international payments will need to be readjusted; then what?"[1] Here is a formidable attack by an impartial and eminent authority on the idea of an irrevocably fixed "natural" ratio. His theoretical argument is strongly supported by the facts of the economic history of India; and India is a particularly good illustration of such theory, in as much as it is a country producing raw materials for which the demand has grown more intense both during the war and after the war when economic reconstruction of the world has increased the demand for such products. At the same time, the demand of India for foreign manufactures has grown less intense on account of the growing industrialization of our country under the regime of Discriminating Protection. The events of the last few decades emphasise the validity of this line of reasoning. Indeed an important contributory cause of the great rise of prices in India before the war was not the Gold Exchange Standard but the ratio which had become ill-adjusted to the circumstances. Thus, in the later period of the war and right upto 1920 not many could be found to urge the claims of the 1s. 4d. ratio as *sacrosanct.* Indeed a leading industrialist and economist of India like Sir V. Thackersey advocated a stabilisation at 1s. 6d. It is also significant that a strong advocate of the 1s. 4d. ratio like Sir D. Dalal proposed a general export tax as the means of keeping up the old ratio. In such an extreme proposal is implied the same basic idea of the dependence of the ratio upon foreign demand for our products which has been explicity put forward by Prof. Taussig. After 1920 came the

(1) Taussig, International Trade, p. 332.

great and general trade depression which for a time lowered the Indian ratio. But the action of the basic economic conditions of the world's demand for Indian products could not be long withstood, and our ratio was not only stabilised at 1s. 6d. but it rose a good deal above it in spite of large purchases of sterling by Government. Indeed "it was believed that Government would not be able to keep exchange from rising considerably above 1s. 6d.". The true correlation thus is to be traced between our exchange ratio and the course of the trade conditions.

Deflation

It has also been contended that the stabilisation and maintenance of the exchange at 1s. 6d. was due to currency manipulation in the shape of "excessive deflation" and "undue contraction of currency in India." It is submitted here that there is double fallacy involved in this line of reasoning. Not only is the extent of the actual deflation exaggerated, but the efficiency of monetary deflation as a factor in monetary stabilisation is unduly magnified. Compared to the great inflation of the war period in India, the deflation of the period from 1920 to 1923, which amounted to about 38 crores, can only be called a moderate one. The fall of prices brought about by it cannot be compared for a moment with the results of contemporary deflation in the United Kingdom or the United States; while it was a long time before any tangible effects of our deflation on the exchanges could be perceived.

The fact is that the recovery of the Indian exchange was due, not so much to the halting and moderate monetary deflation, as to a singularly fortunate combination of the various factors which are recognized as being necessary for currency stabilisation. By 1925 we had the advantage of the restoration of budgetary equilibrium, and we were reaping the benefits of that "financial" deflation which is now recognized by economic authorities as so much more efficacious for stabilisation than monetary deflation. Then,

again, India was entering on a new era of favourable balances of trade, and was showing a recovery from the trade depression which was unique in the annals of post-war commerce. This combination of favourable factors was partly fortuitous, but it was partly also the deserved reward of wise finance and timely deflation, as well as of that patient policy which withstood the temptations to premature stabilisation. It is owing to this combination of factors favourable to stabilisation that India has paid a much smaller price for currency stabilisation than other countries. Countries which have raised their exchange under less favourable conditions have indeed paid a stiff price for the stabilisation in the shape of increased unemployment, and a great strain imposed upon the unsheltered or competitive industries. But to contend (as some critics have done) that India has to face difficulties of the same magnitude in the process of stabilisation, or to argue that the necessary period of readjustment to the variation in exchange should be at least as long in the case of India, is to disregard and ignore vital differences of economic conditions between the countries concerned.

The history of Deflation

A brief review of the history of deflation in India is very necessary in order to get a correct view of its true dimensions especially from the comparative point of view. Let us first consider the years 1920-22, when the need was particularly felt for offsetting the great inflation of the war period and for adapting the volume of currency to the facts and requirements of the period of depression. In this period however, the process of deflation in India was greatly hampered by the budgetary deficits following on the year 1920 which led to a postponement *sine die* of the extinction of "created securities" in the paper currency reserve. "The existence of budget deficits of a substantial amount clearly made currency contraction a matter of difficulty"; nor could the sales of reverse drafts be fully utilised for deflation. The total deflation in 1920-21

amounted to 31 crores. We had nothing like the drastic deflation which took place in Great Britain in 1920-21 which halved prices, and which is now justified even by a stalwart opponent like Mr. McKenna. He observes in his book on Post-war Banking Policy that "deflation, even rigorous deflation, was a harsh necessity in 1920 and 1921." This "monetary" inflation on the lines of the Cunliffe Report was preceded by a "credit" inflation. About the same time a similarly thorough measure of deflation was carried out in America. It was a remarkable chapter in the history of post-war deflation, and by June 1920, the rediscount rate was raised to 7 per cent. High authorities like Dr. Willis assert "the operation of credit control through higher discount rates was a marked success". Mr. Hawtrey observes that "in so far as the expansion had got out of hand, the subsequent contraction had to be more severe".

When compared with the immense inflation in India during and after the war, and the lessened volume of post-war business, the succeeding deflation was certainly partial and hesitating. The extent of the inflation between the years 1914 and 1919 can be judged from the rise of the rupee circulation from 187 crores to 280 crores and of the note circulation from 61 crores to 183 crores. Later, the deficit years were financed by the issue of notes amounting to much above thirty crores. As compared with this huge inflation the deflation could not be said to be drastic in any sense. Even the sale of Reverse Councils in 1920 was not allowed to have its proper effect in deflating currency; since in other ways much of the money was replaced on the market, on the ground that adequate contraction of currency would have been "a hazardous undertaking" and that, too, while the world prices in gold were falling rapidly. The net contraction of currency in 1920-21 amounted to 31 crores and 58 lakhs; but this contraction was found "insufficient even to check the downward fall of the rupee." In the succeeding two years a net contraction of 680 lakhs was made. The credit for the improvement in Indian ex-

change was due far more to the balancing of the budget and to the cessation of the downward movement of the world prices than to this deflation. In fact, anything like a drastic deflation was for a long time out of the question on account of the successive budgetary deficits. And, though the Paper Currency Act of 1920 embodied some ideals of ultimate deflation, even this attempt at indirect deflation was foiled, since the *ad hoc* securities could not be cancelled, and the interest on paper currency securities had to be credited to the general budget. There was still another circumstance which rendered drastic deflation impossible in the case of India, and that was the intolerance always displayed by the Indian money market towards deflation.

A most important circumstances in making the factors of stabilisation favourable to the experiment in India has been the budgetary equilibrium which has been attained for several years in India. This notable factor in the adjustment has not been even referred to in our controversy, where the critics have confined themselves to emphasising and exaggerating the monetary deflation which is a comparatively minor factor in the situation. The economists of Europe have however formed juster notions of the potentialities and important effects of the attainment of budgetary equilibrium. The result of the studies of Prof. Rist on this topic have been thus summarised: "the underlying explanation of the facts of inflation and depreciation lies in the budget situation, and that the very possibility of deflation is dependent on the establishment of budget equilibrium. Granted such an equilibrium, an improvement in exchange will follow of itself, as will a fall in prices. The amount of money is here strictly a resultant."[1] That is one way of stating the thesis; another and perhaps a better statement is that the raising of exchanges and lowering of prices are the common products of the equilibrium of the budget which is the dominant element in the situation.

(1) J. W. Angell, Theory of International Prices, pp. 298—299. See also the Quarterly Journal of Economics, Vol. XXXIX, pp. 280—281 and 294.

In the second period 1922-23 there was a further contraction of about six crores. Such a deflation though not important by itself was assisted by the trade recovery and after a time lag the exchange gradually rose.

A great deal has also been made of the later deflation between the years 1925 and 1927, but it has not always been remembered that important deductions have to be made from the figures of the gross deflation.[1] Between October 1825 and May 15, 1927, the net contraction of the note issue has been 32·10 crores. But, when allowance is made for the 13·14 crores of rupees which came back into the reserves, the net contraction is found to be only 18·96 crores. This last figure has to be reduced further on account of the amount of silver rupees which came out of inactive holdings into circulation and which largely exceeded the amount of such rupees which came into the paper currency reserve. On this account a further large reduction has to be made from the figure of 18·96 crores in order to get at the net contraction.

As regards this third or post-stabilisation period of deflation, it is a great mistake to believe that in the case of India alone continued stabilisation has required contraction of currency, or that in other countries the stabilization has been effected at a stroke and no further measures of deflation have been found necessary. In all countries, a good deal of subsequent regulation of currency and credit has been found to be unavoidable. Indeed it could not well have been otherwise; for there were two important factors which necessitated such action. In the first place the adjustment of international prices had to be effectively se-

(1) The figures are taken from Sir Basil Blackett's statement in an interview on 26th May, 1927. Reference might also be made with advantage to the Report of the Controller of the Currency for 1926-27, pp. 27—28 and for the year 1927-28, pp. 24—25.

cured; and further, we are in a period of slowly falling prices all the world over. Both factors rendered deflation inevitable and deflation has accordingly been carried out. But in other countries, the relative importance of credit is greater and hence the object has been effected to a great extent by a manipulation of the discount rate and restriction of credit. Take for example the case of England. Both English and foreign writers have recognised that since 1925 ''artificial'' measures have been adopted in order to safeguard the stability of sterling. The Bank of England has repeatedly manipulated the discount rate and sold securities and, even so, voices have been raised for the direct reduction of the fiduciary issue. In other countries, too, the statistics of discount rates bear witness to the contraction of credit. Indeed there are authorities who doubt whether British prices are not even now too high at least as compared to continental prices. In case of other countries also, like Belgium ''the readjustment has not yet been completed''.

The tests of undue deflation.

The contention that there has been undue deflation should be judged and appraised in the light of the proper economic tests of such a policy. The steady return of silver rupees from hoards on a large scale for some year succeeding 1924-25 rather shows that such deflation as has been substantially counteracted. In the financing of our great staple crops there has been no difficulty, though there must necessarily have been considerable stringency had there been anything like excessive contraction. Then, as regards bank rates, apart from certain temporarily increases due to the financial strain orginating from America, the discount rates of the years following the adoption of the ratio compare quite satisfactorily with those of earlier years. It might be added that the effects of the American situation were not confined to any one country but caused an international trend towards higher rates of interest which has been quite general from South America on the

one hand, through Europe and so on to Asia. Indeed a study of the history of bank-rates in India and abroad might be recommended to the critics of deflation in India.

We might proceed to consider another test of undue deflation. Is it a fact that in India prices have fallen to a greater extent than in other countries? Such would have certainly been the case had there been such an excessive deflation as has been so often asserted. But the comparative statistics of prices tell a very different tale. Prices in India are at least as steady as in any other country and the tendency towards a decline of prices is if anything less noticeable in India than elsewhere.

Foreign experience of the necessity of deflation.

The advantage of a timely deflation of the currency and the necessity of attempting a reduction of the war—inflation are best illustrated by the economic history of Japan after 1920. The recent work of Dr. Furuya on "Japan's Foreign Exchange" contains a valuable discussion on this topic. We learn from Dr. Furuya that the inflationist group was particularly strong in Japan and constituted the strength of the political party called the Seiyu-Kai which stood for encouragement of industries and trade by the extension of credit and currency. The fact that the post-war depression came earlier and was sharper in Japan than elsewhere is attributed by Dr. Furuya to the circumstance that the Japanese price level was kept so high. One ministry after another neglected the task of reducing the level of prices and confined their effort to pegging the exchanges and putting an embargo on gold. They satisfied their consciences by attributing the enhancement of prices to the world-wide movement. Such an obstinate policy which was resolved not to deflate in time, was responsible, as that auther says, both for the unfavourable balances of trade and to a large extent for Japan's inability to maintain the markets which she had opened up during the war. It was a great object lesson in the advantages of a timely and

moderate deflation. It may be permissible to quote one relevant paragraph from Dr. Furuya's learned and instructive work here: "The blame, however, should not be borne by one Finance Minister but by his political party, the Seiyu-kai. For the Seiyu-kai always stood for the 'positive policy' which meant to encourage industries and trade by extending credits, floating-loans, and by passing various governmental measures of all sorts and undertakings. One natural result of such a policy was to swell the state expenditures thereby to enhance prices as already mentioned.

Thus, when Japan needed an economic readjustment and deflation more than anything else after the War, what she got was the Seiyu-kai's 'positive policy' which caused high prices, excess of imports, unfavourable exchanges, and finally exhaustion of gold funds abroad, as they began to peg exchanges in the early parts of 1921 and 1922 by selling gold funds abroad at the government's desired rates of exchange. It is thus known that the government's artificial pegging was an utter failure," (pp. 132—133).

Adjustment of Prices.

We now approach the most important issue in the ratio controversy—that relating to the adjustment of prices to the ratio. On this point the statistics of prices and exchanges can be appealed to for a decisive and unambiguous verdict.

The proof of the adjustment of the prices in India to the changes in the ratio is contained in paragraphs 183—187 of the Currency Commission Report, and it is clear and cogent enough to bear summarising as regards it main contention, while it can be strengthened by a fuller reference to the conditions and circumstances of the time. We note, in the first place, that the exchanges had been rising very slowly all along the years 1922, 1923 and through the early half of 1924. Meanwhile the prices might be said to have

kept fairly steady, ranging from an annual average of 181 in 1921 to 180 in 1922, to 176 in 1923 and to 178 during the year 1924. Two reflections suggest themselves to us here. In the first place, as we have seen, the steadiness of prices shows that the much discussed deflation must have been of a very moderate character in order to result in such a steady price level. We can indeed go further and assert that it was very necessary in the interests of price stability. In the second place, the period of over three years stretching from the middle of 1921 to the last quarter of 1924 might be said to be the required period of time-lag between the rising exchange and price movements. We note further that after August 1923 there was no further deflation of currency. However, almost a year after the process of deflation had stopped, and just while the exchange was in the course of rising from 1s. 5d. (sterling) to 1s. 6d. (gold), we find a steep and violent fall of Indian prices which carried them from 181, the index number of prices corresponding to October 1924 to 157 in August 1925. Obviously, it is here that we can trace the action of the steadily rising exchange on the price level; for all factors which were likely to affect prices during the year were of a fairly normal character. The process of deflation had already been terminated full fifteen months ago. The trade position was good, but the large exports were balanced by the "colossal imports of bullion". It was obvious, as the Commission pointed out, that the facts and figures of the period unmistakably proved a striking and considerable adjustment of prices to exchange. The central and undesirable fact of the period between July 1924 and June 1925 was thus a striking correlation between the rise of the exchange and the fall of prices.

An attempt has however, been made to explain this away by arguing that the fall in prices was the effect not of the rise of exchange but of the alleged fall of world prices. It is therefore necessary to examine this contention.

From August 1924 to March 1925, for about six months, there was a considerable fall of prices in India; while in United States of America the prices kept rising till March 1925 and in England they kept rising until December 1924. This contrast in price movements it is very necessary to bear in mind for, without any question the fall of prices was due to the rise of the exchange in India. It was the exchange position in India which obviously lowered the price level in India even in spite of any sympathetic effect of high prices ruling abroad for some months more. The world fall of prices manifested itself only after the first quarter of 1925; for up to March 1925 prices were rising in U. S. A. In this later period the exchange stabilised at 1s. 6d., and this factor as well as the reaction of the world prices on Indian prices worked in the same direction. But in view of what took place in the earlier period, there is no reason to ascribe the lion's share of the influence in lowering Indian prices to the latter.

Our conclusion on this point can only be that the fall of prices in India upto March 1925, must be ascribed wholly to the exchange adjustment, and not to any sympathetic action of foreign prices; rather it came about in spite of the general and high trend of world prices. After March 1925, no doubt, the beginning tendency to the decline of world prices needs to be taken into account; but even when dealing with this later period it is well to remember—for one thing —that by that time India had passed through a very large part of her fall of price level; and, in the second place, that the fall in prices in countries like the United States of America was smaller than in India. Obviously, it is impossible to attribute the earlier and the major phenomenon to "the sympathetic effect" of the later and the minor one.

Attention might be drawn in this connection to an exeellent study of post-war price movements by Prof. L. D. Edie of the University of Chicago, which has been published

recently. He observes that "between the first quarter of 1925 and the middle of 1927 wholesale prices fell according to various indexes, from 11 to 15 per cent. During the same period, a world wide decline of wholesale prices was under way. In England, this decline was about 17 per cent., and in fourteen leading countries having a gold basis, the average decline was about 12 per cent. The United States set the pace, all other countries had to adjust their gold values to hers. This meant either inflation in United States or deflation outside the United States. Europe hoped for the former, but finally had to face the latter. The outside world was forced to cut under our prices enough to ward off unfavourable trade balances, support foreign exchange rates, and build up credits abroad wherewith to meet international debts." The above extract will show that in the opinion of a foreign authority on monetary matters the decline of world prices began after the first quarter of the year 1925, i.e., several months after the fall of prices in India under the influence of the ratio.

The Commission could naturally discuss the progress of adjustment of prices only upto February 1926. But in the light of later events, the further adjustment of prices to the ratio is rendered very clear. A reference must be made to the table of prices and ratios which has been used by the authors of the Report, which has been quoted and accepted the dissenting Minutes, and which was expanded and utilised again by Sir Basil Blackett. Bringing the table down to May 1926, i.e., a little before the Commission signed its report, Sir Basil was able to demonstrate the existence of a fairly close adjustment. He put the matter is a nutshell thus:—

		Gold parity of rupee	U.S.A. prices	Calcutta rupee prices
December 1922	...	95	156	176
May 1926	...	112	152	150

It was shown on the basis of these figures that the rise in the gold parity of the rupee during the period was accompanied by a very considerable fall in the rupee prices in India, even when allowance is made for any possible sympathetic action of the fall in gold prices abroad.

A comparative study of international prices since 1926 will reinforce our conclusions as regards the adjustment of prices to the ratio. While the course of prices in India has been generally parallel to the movement of prices in the great commercial countries, the fluctuations in the former have been far fewer. Such an exceptionally smooth movement and trend of prices and the general correspondence with the slightly downward direction of prices abroad would have been impossible with a ratio which had been illadjusted to domestic prices. As we shall see later the adjustment of the general level of prices for imported articles and that for our exports as well as the gradual but sure contraction of the gap between the two sets of prices are also to the credit of a ratio which permits of a gradual and smooth correspondence of relative prices.

Agriculture and the Ratio.

In the dissenting minute apprehensions were expressed as regards the possible disastrous influence of the ratio on the interests of Indian agriculture, trade and industry. We are now in a suitable position in the light of events of judging the value of such prognostications. Considering the position of agriculture first, we find an entire absence of any possible harm wrought by the ratio.

Before coming to study the very limited range of the influence of the exchange factor on the fortunes of the agriculturist in India, we might profitably advert to some much more important world factors which have been affecting agriculture in recent years. We shall find much to learn from the consideration of this broader point of view. It has been observed that in all countries "after a period of

war, farm products seem to suffer in a greater degree from the post-war correction of prices. Naturally, as essentials their production has been stimulated during the war, either by bonuses or by price fixing or by the natural advance of prices, and there is a greater inelasticity in the correction of them''. That dictum of Prof. Hollander summarises the post-war experience of agriculture almost all over the world. It must be remembered that the rise of the prices of farm products was both in India and in many other countries, generally speaking, a continuation of the slower rise of prices since the late 'nineties. However, after 1920, America and Europe saw a cataclysmic fall of agricultural prices. The Indian agriculturist was lucky compared to others, since the fall of prices in India was comparatively small and for him the fall was broken by a sequence of four good monsoons. Nevertheless even in India "the level of food grain prices fell temporarily below that of general prices a little later. It is this relative fall of agricultural prices which has caused such a depression in the world's agriculture. It might be noted further that factors like exchange are in no way responsible for this alteration of relative prices to the disadvantage of agriculturist.

We observe further that since the year 1924 (when the ratio of 1s. 6d. was reached) the relative prices have taken a turn in India favourable to the agriculturist. Looking to the statistics of agricultural prices, we find that the Indian agriculturalist has even gained ground on the manufacturer in this respect. On the one hand, the general price level has been falling slightly in India since the year 1924; on the other hand as the index number of food grains shows, during the same period, the prices of these most important agricultural products have risen substantially. Since it is the food grains which are of supreme importance in the Indian farmer, we see that the agriculturist has gained considerably by the relative price changes since 1924 when the present rate of exchange was reached. That the Indian agriculturist has done well since the year 1924, as regards

food grains which are his chief products, can also be seen from the following figures:—

Period	Cereals	Pulses	Cotton manufactures	Metals.	Other raw and manufactured articles.
1914 (July).	100	100	100	100	100
1915 ...	115	122	97	120	1[illegible]8
1916 ...	106	107	134	186	155
1917 ...	92	96	203	266	183
1918 ...	110	119	298	301	184
1919 ...	163	180	295	236	192
1920 ...	154	166	325	238	231
1921 ...	145	160	280	237	212
1922 ...	137	152	239	175	235
1923 ...	114	112	221	165	207
1924 ...	123	114	229	162	193
1925 ...	136	128	219	131	165
1926 ...	140	149	173	140	141
1927 ..	139	155	159	133	151
1928 ..	133	157	159	125	138

The following observations suggest themselves on a study of these figures, which are of importance both as regards any possible influence of the new ratio on the fortunes of the Indian agriculturist and as regards the condition of the Indian agriculturist during the post-war epoch as compared with that of the agriculturist in other countries. In the first place, we note that the reaction to the inflated war-period prices of agricultural products was, in the case of India, later and less marked than elsewhere. Thus, in the United States, the agricultural prices collapsed in 1920; and it is worth noting that the prices of farm products "fall

first, hardest and farthest''. Those who desire further information on the subject might be referred to a valuable article by Mr. A. B. Genung of Cornell University on ''the Purchasing Power of the Farmer's dollar'' in the annals of the American Academy of Political and Social Science. In India, the fall of agricultural prices was slower and smaller, and became pronounced in 1923. It is further to be noted that in spite of the exaggerations about the deflation in India, the prices of other commodities had not fallen much by that date. Hence we can well call the year 1923, the *nadir* of the fortunes of the Indian agriculturist, since the prices of the main farm products had fallen as far as they were going to during the post-war decennium, while the prices of the commodities which the farmer has to purchase had as yet fallen but little. As Mr. H. A. F. Lindsay has observed in an admirable article on ''India's return to normal'', so far as the Indian agriculturist is concerned ''1923 was his worst year, when the discrepancy between the two (sets of prices) was most marked''.

The next thing to be emphasised is that since the year 1923 the Indian agriculturist has been recovering the ground that he had lost. It is of course a coincidence that the Rupee exchange has been also rising from the same date; but it is obvious that the rising exchange and its stabilisation at 1s. 6d. has in no way prejudiced the farmer. For on the one hand the prices of the most important farm products have gone on rising, while, on the other hand, the prices of other commodities which the Indian agriculturist consumes have fallen. It is not for the Indian agriculturist to complain of such a reversal of the course of relative prices to his advantage; nor does he. For since 1923 the prices of cereals have risen by 25 points and those of pulses by 43 points, while he has been gaining considerably on the prices of the commodities which he has to buy. No better illustration can be brought forward of the crudity of the assertion that the new ratio is going to ruin the farmer.

The fact is that the influence of the change of ratio on the fortunes of the agriculturist is small and indirect compared to that of other great factors like the cycle of seasons and alterations in the relative prices of agricultural and other products. In the recent ratio controversy, the losses of the cultivators from the rise of the ratio to 1s. 6d. have been placed at fabulous sums which shake rather than support the argument based on them. The change of ratio is alleged by one controversialist to have caused a loss of a hundred crores a year to the Indian agriculturist, while others increase the alleged burden to 200 crores of rupees and even to 250 crores. To complete the tale of wrong, it is added that the agriculturist has lost a few hundred crores more by the fall in the price of silver which is alleged to be a result of the alteration in our exchange. The resources of our agriculturists must be unlimited, indeed, to have been able to stand all these alleged burdens. Those who made such allegations forgot the adjustment of the prices of the articles purchased by the agriculturists. They also forgot that had the Indian agriculturist been labouring under burdens in any degree approaching those alleged, unmistakeable testimony would be borne to the supposed facts not only by statistics of forfeited mortgages, evictions, default in revenue payments and of rise of interest rates but by agrarian disturbances and agricultural conditions in general.

Not only are there no signs of any agricultural troubles such as were both predicated and prophesied, but the verdict of Co-operative statistics can be appealed to in order to demonstrate that under the new ratio, agriculture has been as flourishing as it was under the former ratio. There can be no sort of doubt that the Co-operative agricultural societies, being scattered fairly evenly all over the country, can be taken as representative of the general agricultural conditions. The statistics of such societies are therefore specially useful for testing the conditions of agriculture in general, supplemented as they are by journals edited by

numerous and able non-official workers in the co-operative sphere. Now, if the alleged great increase of the burden of the agricultural debt and the material reduction of cultivators income had been positive facts we would expect to find the following symptoms among others of the disorder; (a) the growth of the capital and deposits of the rural societies would have been checked; (b) the proposition of arrears to outstandings would have increased largely; (c) loans for unproductive purposes, like repayment of debts would have increased materially; (d) the rate of interest on loans would have gone up. As a matter of fact the Co-operative statistics of the years following 1923-24 show no such adverse symptoms but tell a tale of continued prosperity. They point to a rapid increase not only of the number of societies but of deposits as well as average capital and general resources. The figures of overdues and arrears show improvement if anything. Nor do we trace any rise either of the interest rates or of unproductive loans. Nor, among the numerous articles contrirbuted by officials and non-officials to the various co-operative journals of India can one find any mention of unfavourable agricultural conditions. Surely, if Indian agriculture was adversely affected by general factors of currency and exchange, it is not possible that the co-operative section would have alone passed unscathed and even prospered.

Foreign Trade and the Ratio.

There are at least three aspects of the fortunes of Indian foreign trade under the regime of the new ratio which deserve careful examination. In the first place attention might well be directed to the relative movements of the volumes and prices of our export and import trades. We might then observe the course of our balances of trades. Lastly we might consider the fluctuations of some of our leading exports and imports.

I. Coming to deal with the adjustment of the relative volumes and values of our export and import trade we notice that within a quinquennium of the attainment of the new ratio the volume of imports and exports have all but attained their pre-war normal. The course of trade has been well illustrated by the following figures in the Review of Trade of India for 1928-29.

—	1913–14	1920–21	1921–22	1922–23	1923–24	1924–25	1925–26	1926–27	1927–28	1928–29
Imports ...	183	142	124	138	120	137	143	156	181	190
Exports ...	244	172	182	214	240	250	246	228	248	260
Total trade in merchandise, excluding re-exports ...	427	314	306	352	360	387	339	384	429	450

The reversion to the pre-war and normal relations of the export and import trades is here strikingly brought out. The import, trade had reached its last minimum in 1923-24 and by the time the 1s. 6d. ratio was established in 1925-26 it had proceeded very materially towards its recovery to the pre-war level. Nor has its further recovery been artificially hastened by the new ratio, for the rate of progress of imports remained much the same before as after the advent of the new ratio. There is thus no tangible evidence of any particular bounty to imports. For while at the present day the volume both of imports and exports is above the pre-war figure it is the export figure which rose in 1927-28 above the figure for 1913-14 and further, in 1928-29 (at the values of 1913-14) it rose far higher above the latter figure itself. Consequently there is no ground for the idea that the new ratio has kept back our exports. The Review remarks very properly that "the trade figures of the year 1928-29, as calculated on the basis of the declared value of 1913-14, *are a record for both imports and exports. Im-*

ports at the values of 1913-14 *in* 1928-29 *surpassed the figure for* 1913-14. *Similarly exports surpassed the pre-war figure as well as the record figure of* 1924-25. The total trade in merchandise, excluding re-exports was the highest on record". This is surely the *reductio ad absurdum* of the contention that the new ratio has been encouraging imports and hampering our exports.

We shall proceed now to emphasise another equally important point—the adjustment of the general level of prices for the exported and imported articles. It is obvious that a true adjustment of the relative values of our imports and exports is essential for a stable and sound position of our foreign trade. The figures illustrating this process of adjustment are again borrowed from the last Review of Trade:—

—		1913-14	1920-21	1921-22	1922-23	1923-24	1924-25	1925-26	1926-27	1927-28	1928-29
Imports	...	100	237	214	169	190	180	158	148	136	133
Exports	...	100	140	127	140	144	154	152	132	130	127

The Review states that "the margin between the import and export prices was identical with the previous years. Prices of imports and exports declined by about three points each as compared with the preceding year". Such a harmonious movement of export and import prices speaks well for the conditions under which the movements took place. But the matter admits of further consideration and development. If we compare the movements of import and export prices since 1925-26 (the year of the introduction of the 1s. 6d. ratio) we find that the general level of articles *both of export and import has fallen by fifteen points.* Such a full and exact adjustment of the level of export and import prices indicates a rapid return to the normal of economic position of the country. It can be reasonably inferred that the ratio which permits of such smooth and

rapid adjustments must be a ratio well adjusted to the economic situation.

It might be added that the problem of the relative volume and values of imports and exports is a far wider problem than that of the ratio and involves a consideration of many other important factors. For one thing the fact that the decline of prices has been somewhat greater in certain European countries than in India has by itself a tendency to stimulate our imports. Then again, export prices in several countries have been artificially lowered to meet the conditions of industrial and trade depressions. Finally the ratio of interchange of manufactured goods and other products is being readjusted in favour of the latter. All these factors might be expected to lead to an increase of our imports of manufactures. Under such circumstances, if our exchange ratio, had been fixed too high, as has been contended, India would have seen a phenomenal increase of imports. As a matter of fact, however, no such result has followed and this must allay any suspicion regarding our exchange ratio.

II. The statistics of the balances of trade of our country since the inauguration of the new ratio are also of a very satisfactory character. This will be made clear by the figures. Thus the balance of trade in merchandise was in favour of India to the extent of Rs. 86 crores in 1928-29, as compared with Rs. 82 crores in 1927-28 and Rs. 79 crores in 1926-27. This compares favourably with the pre-war average of 78 crores and the war average of 76 crores. The critics of the new ratio argue fallaciously by taking the figures of the record year 1925-26 as their starting point and professing to regard the figure of the visible balance of trade for that year as the normal one. So far however was the record of that particular year from being a normal one that its visible balance of trade was far more than double the pre-war average. Indeed the figures of the excess of exports for that year are unique in the economic history of

India. On the other hand the figures for the year 1928-29 form another sort of record when the total volume of import and export trade stand unapproached in the economic history of the country. And the latter record is of a more desirable character of the two since it assures harmonious and pari passu development of both branches of our trade. —especially as the *volume, even of the export trade was certainly larger in* 1928-29 *than that attained either in* 1924-25 *or* 1925-26. As Taussig has observed: "Let us not fall, as involuntarily we do, into the deceitful belief, or perhaps the flattering unction, that the sending of goods abroad is in itself a thing which brings money into the country and thereby makes us all more prosperous. Let us hold fast to the fundamental principle that the exports are the means of producing the imports, and that only if there be real effectiveness, real success in the application of our labor and capital, does the country gain." But even the most captious critics of the currency policy of India can not be dissastified when, under it, not only imports but exports make unprecedented records.

In the present controversy much has been made of the fact that in 1924-25 the imports of gold were exceptionally large and have not been maintained at that level, and it has been inferred from it that the purchasing power of important classes in the country has been reduced. The answer might be suggested that the imports of gold in 1924-25 were exceptional and were "due mainly to the large fall in the price consequent upon the rise in the gold value of the rupee and the possibility that this drop in price would be temporary". Allowance has also to be made for growth of the habit of foreign investment in India. It is further only to be expected that if the country buys in any particular year twice or thrice the normal amount of the precious metals, the demand must be temporarily satiated and must fall off to some extent in subsequent years. Imports of gold are influenced by quite a number of causes among which the ratio occupies quite a minor place. Among these

factors might be mentioned the present scramble for gold between a great number of countries, the embargo on the export of gold in many countries, the policies of central banks and the course of international loans. In fact the present situation as regards the international distribution of gold is quite an abnormal one. Again if we take the imports of gold and silver together the average imports since the introduction of the new ratio are quite comparable with the pre-war average. They appear small only when they are compared to the two, record years for the import of precious metals, viz.:— 1924-25 and 1925-26 which of course, stand by themselves. Finally, the diversion of the purchasing power from the precious metals to other commodities argues no general reduction of that power. At any rate those who regret the growth of imports cannot also complain of the reduction of the purchasing power of the people.

III. The most important aspect of any study of the course of our foreign trade must consist of an examination of the fluctuations of the main staples of our exports and imports. Among our competitive exports we shall study first the exports of that industry which has complained most of the new ratio. We find that right upto the year 1926-27 the exports of Indian piece-goods went on growing very steadily and that the exports of that year formed our high water-mark in that line. It is only when we approach the period of the present labour troubles in that industry that these exports decline. A contributory cause of this decline has also been referred to in the last Review of Trade. "As in the previous year the declared values of exported piece goods were higher than those of imported piece-goods and this indicates the principal cause of the retrogression of Indian piece-goods trade in overseas markets". No change of ratio can possibly remedy these two causes of the decline in this line.

Coming to another head of exports, since the year 1924 the total exports of hides and skins have gone on making

steady progress throughout the last quinquennium. Our exports of tea can be shown to present an equally satisfactory condition—rising from 340 million lbs. in 1924-25 to 359 millions in 1928-29. It is even more significant that our total exports of oil seeds which amounted to 1,250,000 tons even in the record year 1925-26 have grown to 1,328,000 tons by 1928-29. And that in spite of constantly increasing competition from abroad as well as the growing local consumption which is out-bidding foreign demand.

Even now there are not wanting critics of the ratio who repeat the old fallacy that a high exchange is good for the foreign trade of a country. Such critics ignore the distinction between a *falling* exchange and a *low* exchange. While a falling exchange might help exports a low exchange has no such tendency for an adjustment of cost and prices to the new ratio is inevitable. A study of post-war balances of trade proves the truth of this proposition and might be recommended to the advocates of a low exchange. The case of France is particularly in point as many of our champions of 1s. 4d. ratio have envied France its great fall of exchange. The fact is that while the falling exchange helped the exports of France and contributed to secure the large favourable balances of the years 1926 and 1927, the very low exchange at which stabilisation was effected had no such effect. For the adjustment of prices to the new ratio took place quickly and the year 1928 (the very year of stabilisation) saw a return of the unfavourable balance of trade in spite of the heavy devaluation.

There are not however lacking signs that even the critics of the 1s. 6d. ratio have at last seen that it is in vain to appeal to the figures of the foreign trade of India. Thus in the "Capital" of 20th September 1928, Sir Purshotamdas Thakurdas had argued that "the ratio had had an adverse effect on the trade of the country". But speaking before the Legislative Assembly on the 4th March 1929—that is, only six months after he observed as follows:—"*It is not much*

good quoting to us figures of foreign trade and railway returns. The holding capacity of the cultivators of India is proverbially small. The railway returns can therefore not show a falling off. If industries in India have not been encouraged by an active policy of protection, is there any wonder that your foreign trade returns have kept up with normal years? Why go only on the foreign trade and the railway returns? The crops if grown, whatever the price may be have to move". Here is at last a full and frank admission that the ratio has had no adverse effect whatever on our foreign trade. Coming from the author of the Minute of dissent such an open and ingenuous admission is to be specially valued. There are however one or two oversights in it. It is not merely the volume of imports that has attained its tallest record by 1928-29 but also that of the exports. Hence the reference to protection is redundant. Further it is not a fact, as suggested in the speech, that the Indian agriculturist has had to sell his produce at low prices. Taking together the prices of cereals and pulses (in which our agriculturist is mainly interested) a record of high agricultural price was reached by the latter part of the year 1928.

The ratio and Industries.

The four years that have elapsed since the inauguration of the new ratio have naturally cleared many of the issues in our currency controversy. For one thing it is now evident that the position of the Indian agriculturist has in no wise been adversely affected. Nor, as we have just seen, are the figures of our foreign trade such as to shake our confidence in the ratio. There remains only the argument that the industries of the country are depressed on account of the ratio. In considering this aspect of the controversy attention might well be directed in the main to the piece-goods industry which is alleged to have suffered most grievously owing to the ratio. It is one of the representative industries of the country and has a

high claim to the anxious solicitude of all Indians. If indeed the depressed condition of this industry is in any important measure due to the ratio there is a heavy count against the currency policy.

In studying the affairs of the industry the verdicts of two economic and technical inquiries which have been recently conducted with regard to it are entitled to due consideration. Thus, before the Indian Tariff Board Sir P. Thakurdas, the late Mr. B. F. Madon and others ably advocated the view that the depression in the industry was due to the factor of exchange. As Mr. Madon put it "the real difficulty is the twisting up of costs and charges through exchange manipulation" Sir Purshotamdas also gave to "the mismanagement of the Indian currency" the foremost place among the factors of depression special to India. After a searching inquiry, however, the Cotton Tariff Board arrived at the conclusion that the stabilisation of the rupee at 1s. 6d. was only "a temporary handicap imposed on the industry". That its importance was not great might be inferred from the Cotton Board's dictum that they "should have had considerable hesitation in proposing an increase of import duty on this ground alone"—even "a small increase, all-round increase", be it noted. The additional protection proposed by the Cotton Tariff Board was based on the ground of unfair competition from Japan and was "justified for such period as the labour conditions in Japan continue inferior to those in India".

The other inquiry has been conducted by Mr. G. S. Hardy, (Collector of Customs, Calcutta) in the year 1929. He shows by a consideration of the statistics of the industry, how little of its troubles can be justly attributed to the 1s. 6d. ratio. The following extract from his report will make the matter clear. "While the Bombay millowners have insistently attributed a large part of their troubles to the fixation of the rupee at 1s. 6d. it is significant that whereas their gross output remained stationary during the three years

1921-22 to 1923-24 in which the rupee was pursuing a fluctuating but upward course, their output again began to rise steadily as soon as exchange was settled in the neighbourhood of 1s. 6d. In fact while the output of the Bombay mills rose 856 milyards in 1923-24 to 1135 in 1926-27 and fell, owing to labour troubles to 1131 and 537 in the next two years, the output of other Indian mills rose from 847 millyards in 1923-24 to no less than 1356 millyards in 1928-29, an increase of 60 per cent in 5 years." Mr. Hardy's view is supported by the figures for the exports of piece-goods from India which continued to increase after the introduction of the new ratio. The chief factor in their recent decline consists of the higher prices of our exports. Mr. Hardy has also shown that the severity of external competition has very recently increased in a few well defined classes of grey and coloured goods coming from a particular country or countries. Had the severity of competition been due to a perfectly general cause like the currency policy or the ratio the increased competition would have been felt over piece-goods generally and would not have been confined to a few particular classes of piece-goods like grey shirtings, printed drills and woven twills from Japan and printed flanellettes and twills from Italy. As Mr. Hardy remarks "imports of these have quite recently increased very rapidly and the prices at which they are sold are surprisingly low". Any adverse effects from the ratio or the currency policy can not possibly concentrate themselves on a few isolated groups of piece-goods. Take again the figures for imports into Bombay itself during the last few months. During the months of April to October (1929) the imports into Bombay of cotton grey piece-goods increased in value by 91·1|4 lakhs. But as Sir F. Sykes pointed out in his recent speech to the Chambers of Commerce this was more than counterbalanced by a much greater decrease in the arrival of white and coloured cotton piece-goods. Taking a wider view and looking at the general figures of such imports into India since 1924-25 we notice that there has been a decline in the

imports of grey goods, a great increase in coloured goods and little change in the white trade. It would be very difficult to explain such varied phenomena in the light of the popular theory that the new ratio gives a bounty to imports in general.

The opinions held by representative mill-owners and experts regarding the influence of the ratio upon their industry will repay a careful study. Both Sir Victor Sassoon (in his evidence before the Royal Currency Commission) and Sir Purshotamdas Thakurdas (arguing before the Textile Tariff Board) have urged that the principal way in which the 1s. 6d. rupee hits the mill industry is by undermining the purchasing power of the agriculturists. But as we have seen the statistics both of agricultural prices and of imports lend no support to this view. The prices of the main products of Indian agriculture have been steadily rising while the prices of the articles which he largely consumes have been falling. It is obvious then that the purchasing power of agriculturists has been on the increase. This is supported also by the phenomenal increase of the output of Indian mills (outside Bombay) by no less than 60 per cent. in the five years ending in 1928-29 as also by the course of piece-goods and other imports.

In the year 1925, Sir Victor Sassoon, representing the Bombay Mill-owners Association informed the Royal Currency Commission that 3·1|2 per cent. represented the difference made to the textile industry by the rise of the ratio from 1s. 4d. to 1s. 6d. He observed as follows: "I have worked out the difference between the present 1s. 6d. rate and 1s. 4d. rate as a very little less than the excise. So to-day with the excise removed, all we are getting is, I think, a ·03 per cent. advantage over what we would have had if the excise had been left on and we had our 1s. 4d. gold as we had last year". The obvious inference is that whatever adverse effect was supposed to have been produced by the

rise to 1s. 6d. was substantially counteracted by the removal of the excise. The figure put forward by Sir Victor Sassoon regarding the maximum burden which could possibly have been imposed on the cotton industry by the new ratio were corroborated by the statement of another Bombay expert before the Currency Commission that there had been adjustment to the ratio regarding 67 per cent. of the cost of production in that industry. For 60 per cent. of its cost of production is the cost of cotton while another 7 per cent. of its cost of production represents the cost of imported stores and machinery. When these views expressed before the Currency Commission by eminent experts like Sir V. Sassoon were put to the leading critics of the ratio before the Textile Tariff Board there was no attempt either to refute them or to put forward any other figures. So they might be expected still to hold the field.

But the truth is that the depression in our textile industry is due to a multiplicity of factors which have little to do with the exchange. It is a suicidal policy to harp on the ratio and to try to divert attention from the really important factors in the situation. Amongst these latter might be mentioned the growth of textile industries in Japan and other competing countries which are backed up by magnificent buying, selling and financial organisations. It is not merely that the manufacturing power of our competitors has increased during and since the war but the whole organization of their industries has been improved in every direction. The superior organizing power of the Japanese manufacturers is also seen in the various ways in which they have worked to offset the reduction of hours of labour and the prohibition of night-work for women and children. On this topic a reference might be invited to a valuable article by Orchard in the Political Science Quarterly for June 1929. On the other hand in India we have not overhauled our industrial organization in the line for many years. Then again it is quite likely that the world in

general and India in particular has been witnessing for some years an over-production of coarse cloth and this is supported by the growing manufacture of such cloth abroad as well as by the increase by mills out of Bombay of their output by 60 per cent. in five years. Deprived of its yarn trade with China our mills have to produce more and more coarse cloth and to force the sales of this increasing mass of production. Even when we come to apply protection as a remedy for this state of things it will have to be applied in the right direction very tactfully and with some moderation. For protection is bound to raise the price of our cloth and hence to reduce sales in India. Abundant experience has shown how elastic the Indian demand for piece-goods is. Consequently the use of protection will by itself have no lasting effect on the fortunes of the industry unless we have a simultaneous introduction of that "rationalisation of managing control" upon which Sir F. Sykes has recently laid so much stress. For more than a decade the cotton industry has been exhorted by its best well-wishers and advisers to overhaul its organisation and methods and the need for such a procedure is the more pressing now, since in the post-war epoch all our rivals from Lancashire to Japan have effected great economies and have improved their organization. That the chief rival of our cotton industry is fully alive to the need for constant improvement in organization is obvious. This is emphasised by Dr. Shuichi Harada in his recent work on "Labour condition in Japan" that "the application of high-grade labor-saving devices, large scale production and the adoption of scientific management have achieved for the cotton industry the largest and the most representative place in Japan". Since the war there is proceeding a great race between industrial countries for improved organization and reduced costs of production; and we must join in it whether we would or no. It is no good arguing as was done before the Cotton Tariff Board that no improvement in organization is necessary in India for "our mills were able to do well in the pre-war

days under similar conditions of organisation.'' For much water has run under the bridges since then and great advances have been made in textile organization abroad.

But while much good can certainly be achieved by a judiciously directed policy of protection, there is nothing whatever to gain by an alteration of the ratio. Indeed it is not difficult to show that a reversion to the former ratio under the present circumstances is to be avoided in the very interests of industry in general and of the cotton industry in particular. Amidst the present tension between capital and labour such an alteration of the ratio would cast a new bone of contention between the parties and would bring about a fresh epidemic of strikes all over the country. In its present mood labour is not at all likely to be content with its present wages when general prices rise 12½ per cent. as the result of the lowering of the exchange. Labour would in fact at once assume that profits of industry in general had arisen permanently by 12½ per cent. and would put in a claim for a similar rise of wages. It could quote our industrialists and critics of the ratio against themselves—and with perfect justification. They would be incessantly reminded that they had prophesied complete prosperity and large profits for the industry, an immense increase in the purchasing power of the consumer and the removal of serious handicaps of the industry as the result of the change in the ratio. They would be held to all their promises, and labour would proceed to exact the full pound of flesh from them.

It is a mistake to think that it is only a period of falling prices which is favourable to epidemics of strikes. Those who believe this half-truth have not fully studied the history of strikes before the war. In a meritorious work on ''Monetary Stability'' Mr. Bellerby has given a full statistical account of the course of strikes during periods of rising prices. After a statistical correlation of strikes and rising prices he observes: ''It is to be seen from the above

figures that the period of trade boom and crisis about the year 1907 was accompanied by a pronounced increase in the number of trade disputes. This increase was, however, of minor importance compared with the bigger swelling movement from 1911 to 1913—a period which followed a gradual rise of some 10 per cent. in the price level and the cost of living. From this it would seem at the outset that a long-period movement in the level of prices—no matter how gradual—is equally detrimental to industrial relations as the more brusque movement associated with the trade cycle.'' He concludes by noting that ''an upward trend of prices, by causing a corresponding increase in living expenses, leads inevitably to demands for higher wages, arising in circumstances which make for distrust and resentment rather than for amicable agreement. A serious outburst of industrial disputes almost invariably ensues. The gain from the change in the ratio would be a merely temporary matter until new adjustments are effected. But the expectations aroused from the step are so great that the rapid rise of money wages which the raising of the ratio has helped to check for the time being will be sure to resume its march and will inflict a new and permanent burden upon industry. The result of the recent Ahmedabad Mill dispute and the increase in wages awarded by the umpire in that affair should serve as a warning that labour is on the alert for any chances of increase in wages and that it will make the most of a chance like the alteration of the ratio. Any gain to our industrialists from the change of the ratio is bound to be temporary and partial while the demand for the raising of wages will be a permanent and general one. The question has been often asked whether the wages have adjusted themselves to the higher ratio. The best answer to that question will come when money wages resume their upward progress with a reversion to the former ratio.

In conclusion it might be pointed out that since the year 1925-26 Indian export and import trade has made new

records, the internal price-level has been as steady as in any other country while the tendency towards a return to normal conditions has manifested itself unmistakable in quite a number of directions. Among these might be mentioned the balances of trade, the relative prices of agricultural and other products and the adjustment of the general levels of the prices of imports and exports. In spite of these undeniable facts there is no end to the devising of new arguments against the ratio. For, as has been remarked in the latest text book of Indian Economics written by the well-known Indian professors "the new ratio will be made answerable for every kind of misfortune and it bids fair to take its rank along with the drain theory as an all—sufficient explanation for every conceivable evil". In this spirit attempts have been made to hold the ratio responsible for the recent rise of the bank rate. If, however, the critics had studied the matter comprehensively and carefully and had compared the money-rates in India with those prevailing in other leading countries since the year 1923 or 1924 they would have seen that there was no reason to suspect any special tendency towards the rise of such rates in the case of our country. And, as to the rise of the rates on certain occasions during the last year, they were a result of the growing monetary strain in the world. The financial strain was tremendous in all the leading countries. Several European central banks lost more gold from their reserves than they could really afford; quite a number of countries placed an embargo upon the gold shipments to resist the drain of funds to America; and the rise of bank-rates was a world-wide phenomenon. The extraordinary drain of funds from all countries to America was exaggerated by the American policy of interning the gold as it arrived. Meanwhile for the rest of the great commercial countries the choice lay between either exporting gold or raising their bank-rate. Like other such nations India too made her choice and raised the bank-rate. There is no denying that high bank-rates are a burden to trade and industry. But

the rise of the bank rates in India during the last twelve months was only a result of the general financial strain in the world and it has no relevance whatever to the ratio question in India. Its only lesson for India is the necessity of establising a Reserve Bank as soon as possible.

In the economic history of India the quinquennium following the year 1924 will be remembered as the epoch of the country's return to normal conditions,[1] whether as regards trade, finance or currency; and in this process of the restoration of the normal conditions (which had been disturbed by the war and its *sequelae*), the new ratio has borne its part well. Allowing for changes in the price levels, the exports and imports trades have been regaining their pre-war level, and so has the balance of trade. Indian prices, too, have been kept steady, and we have an equilibrium of price level with other leading countries. Another feature of the period has been the removal of the disparity and divergence between the prices of agricultural and other products which was acting adversely to the interests of the agriculturist. Such a reversion of trade and price conditions to normal and healthy standards could not have been possible with a ratio which was unsuited to, or out of harmony with, the prevalent economic conditions. Had the present ratio been ill-adjusted to its economic environment, it would have rendered such a rapid and decisive re-establishment of the general economic equilibrium impossible. In fact, the best proof of a well-chosen ratio consists of its harmony with a steady and moderate price level and a healthy and normal condition of imports and exports.

(1) *Cf.* an Article by Mr. H. A. F. Lindsay in the *Commercial*, published by the *Manchestor Guardian* in January, 1921.

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